PROPOSED LEGAL FRAMEWORK FOR REPO TRANSACTION*

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ABSTRACT

The never-ending development in financial industry has one obvious goal to initiate financial product or arrangement that provides not only wider range of accessibility to financial resources but also stronger assurance for the compliance or the remedy in case of incompliance. Generally, financial products should be equipped with cost and time saving qualities as well as reliable risk mitigation approaches. Title finance or title-based financing is a financial arrangement designed to eliminate all these problems. This arrangement offers creditors stronger assurance, since the title of the assets is collateralized in order to put the creditor in a super-priority position. This kind of financing is not new; in fact, it is of the same concept as a well-known sale with the right of redemption, title retention, financial lease, as well as factoring, securitization, and sale and lease-back agreements.

This article will introduce one interesting transaction constituted as title finance. A repurchase agreement ("repo") is a transaction in which one party sells its securities to another in exchange for funds with the agreement that the first party will repay the funds with an additional amount in return for the equivalent in securities from the latter. The underlying purpose is not only the ownership of securities, but also the provision of funds with stronger assurance from title ownership. With its underlying nature of formal-less convenience and reliability, repo constitutes a well-established financial product that is widely used in major financial markets in a variety of developed and developing countries.

For Thailand, repo was first introduced in 1979 and has continued to be developed from merely monetary policy and liquidity management between the Bank of Thailand and financial institutions, in the structure of bilateral repo, to engagement among private sectors, as known as private repo transactions, which will be focused on this study as one interesting financial sources. However, despite constant improvements, the existing laws and regulations remain inadequate in terms of facilities in the transactions, especially on private repo transactions. The ongoing issues are both legal and policy related. Namely, the issues of dissociated definitions regarding characteristics, withholding tax matters that contradict to the underlying taxation policies, the lack of solid legal certainty that can result in ineffective enforceability, and the need of some operation systems for further improvement.

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* The article is summarized and rearranged from the thesis "Proposed Legal Framework for Repo Transactions" Master of Laws Program in Business Laws (English Program), Faculty of Law, Thammasat University, 2015.

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This article then provides a comprehensive study on legal approaches towards repo transactions in such leading jurisdictions as the US and EU to compare with Thailand. The analysis has been given on the mechanisms, problems, and varied resolution approaches taken by such jurisdictions to find some recommendable approaches that can possibly adapt to the situation faced in Thailand private repo transaction.

As a result, this article offers certain suggestions and guidelines to reach appropriate legal framework for private repo transactions in Thailand. Namely, to provide an assurance on validity and protection from recharacterization risk, instead of categorizing the transactions into existing principle of contract laws, repos is proposed to be recognized by its actual character as one form of financial agreement in which the title ownership is transferred to facilitate risk management. Secondly, the proposal is given to consider exempting withholding of certain types of exempted tax for private repo transactions. This tax incentive will eliminate unnecessary procedures and save costs and encourage potential participants to consider a private repo as a wider channel to financial arrangement. Third, in terms of enforcement, considering from one core purpose to create an effective and cost-saving financial arrangement and to mitigate the risks to the minimal level, the law should ensure the enforcement measures either in case of general default or the bankruptcy process, not just by selling out, but also by other practical means agreed, such as close-out or netting. Lastly, the development and improvement of repo transactions requires a great deal of cooperation by all the related parties. The support, both theoretically and practically, such as education for wide range of understanding and supporting systems should be given. The mistakes made and ways of resolving problems can be compared, learned and adopted in order to create sustainable development.

Keywords: Repo, Title Finance, Financial Arrangement

บทคัดย่อ

การพัฒนาอย่างไม่หยุดยั้งในภาคการเงินมีวัตถุประสงค์หลักอันสามารถเห็นได้อย่างชัดเจนคือ การคิดค้นผลิตภัณฑ์หรือธุรกรรมทางการเงินที่ไม่เพียงแต่ขยายช่องทางการเข้าถึงแหล่งเงินทุนแต่ยังช่วยสร้างความมั่นใจว่าธุรกรรมดังกล่าวจะสามารถสัมฤทธิ์ผลตามวัตถุประสงค์หรือมีช่องทางเยียวยาที่มีประสิทธิภาพหากเกินการผิดสัญญา ทั้งนี้ ผลิตภัณฑ์ทางการเงินที่ดีควรมีคุณสมบัติในด้านการประหยัดค่าใช้จ่ายและเวลา รวมถึงมีวิธีการในการบริหารจัดการความเสี่ยงได้อย่างเหมาะสม การจัดหาเงินทุนโดยการใช้กรรมสิทธิ์ในทรัพย์สินเป็นหลักประกัน (Title Finance หรือ Title-Based Financing) คือธุรกรรมทางการเงินซึ่งได้รับการออกแบบเพื่อจัดการปัญหาดังกล่าว ธุรกรรมดังกล่าวช่วยสร้างความมั่นใจอันมั่นคงมากขึ้นให้กับเจ้าหนี้ด้วยการใช้กรรมสิทธิ์ในทรัพย์สินเป็นหลักประกัน ซึ่งจะช่วยให้เจ้าหนี้ได้รับการป้องกันระดับสูง (Super-Priority) ในความเป็นจริง ธุรกรรมทางการเงินลักษณะนี้ไม่ใช่ของใหม่ แนวคิดดังกล่าวได้ปรากฏอยู่ในธุรกรรมทางการเงินที่เป็นที่รู้จัก อาธิเช่น ขายฝาก การซื้อขายแบบมีเงื่อนไขหน่วงกรรมสิทธิ์ (Title Retention) สัญญาลีซซิ่ง (Financial Leasing) แฟคตอริ่ง (Factoring) การแปลงสินทรัพย์ให้เป็นหลักทรัพย์ (Securitization) และการขายและเช่ากลับ (Sale and Lease Back Agreement)

บทความนี้นำเสนอธุรกรรมที่มีลักษณะของ Title Finance ประเภทหนึ่ง คือ ธุรกรรมซื้อคืน (Repurchase Agreement: Repo) อันเป็นธุรกรรมซึ่งคู่สัญญาฝ่ายหนึ่งขายหลักทรัพย์ให้กับคู่สัญญาอีกฝ่ายเพื่อแลกเปลี่ยนกับเงินสด โดยมีข้อสัญญาว่าคู่สัญญาฝ่ายแรกจะทำการชำระราคาในจำนวนที่สูงกว่าเพื่อเป็นการซื้อคืนหลักทรัพย์เทียบเท่า (Equivalent Securities) ซึ่งอีกฝ่ายมีหน้าที่จะต้องโอนคืนให้ วัตถุประสงค์ของธุรกรรมนี้ไม่ใช่เพียงการโอนกรรมสิทธิ์ในหลักทรัพย์เท่านั้น แต่รวมถึงการจัดสรรเงินทุนภายใต้การรับประกันที่มั่นคงกว่าจากกรรมสิทธิ์ในทรัพย์สิน โดยลักษณะอันเป็นการอำนวยความสะดวกจากการลดภาระทางรูปแบบและความน่าเชื่อถือ รวมถึงการประหยัดเวลาและค่าใช้จ่าย ธุรกรรมซื้อคืนได้รับการถือเป็นผลิตภัณฑ์ทางการเงินซึ่งนิยมใช้อย่างแพร่หลายในตลาดเงินขนาดใหญ่ทั้งในประเทศที่พัฒนาแล้วและประเทศที่กำลังพัฒนา

ในประเทศไทย ธุรกรรมซื้อคืนได้ริเริ่มในปี พ.ศ. 2522 และได้รับการพัฒนาจากการเป็นเครื่องมือในการดำเนินนโยบายทางการเงินและการดำรงรักษาสภาพคล่องระหว่างธนาคารแห่งประเทศไทยและสถาบันการเงินต่างๆ ในรูปแบบของการทำธุรกรรมซื้อคืนแบบทวิภาคีกับภาครัฐ (Bilateral Repo) มาจนถึงการเข้าทำธรุกรรมซื้อคืนภาคเอกชน (Private Repo) อันเป็นธุรกรรมที่มุ่งเน้นในบทความนี้ ในฐานะที่เป็นเครื่องมีทางการเงินที่น่าสนใจอย่างหนึ่ง อย่างไรก็ตาม แม้จะมีการพัฒนาอย่างต่อเนื่องกฎหมายและระเบียบต่างๆ ยังคงขาดความสมบูรณ์ในด้านการส่งเสริมการเข้าทำธุรกรรม โดยเฉพาะในส่วนของธุรกรรมซื้อคืนภาคเอกชน ปัญหาและอุปสรรคต่างๆ มีทั้งปัญหาด้านกฎหมายและด้านนนโยบาย อาทิเช่น ประเด็นปัญหาจากความไม่สอดคล้องของคำนิยามลักษณะของธุรกรรม (Characteristic) การเก็บภาษีโดยการหัก ณ ที่จ่ายอันขัดแย้งกับนโยบายทางภาษีที่วางไว้ การขาดความแน่นอนในกฎหมายเกี่ยวกับการบังคับตามสัญญาอย่างมีประสิทธิภาพ และความต้องการด้านระบบการดำเนินธุรกรรมเพื่อการพัฒนาต่อไป บทความนี้จึงนำเสนอการศึกษาและการทำความเข้าใจในส่วนของแนวทางทางกฎหมายของธุรกรรมซื้อคืนในสหรัฐอเมริกา และสหภาพยุโรปเพื่อเปรียบเทียบกับประเทศไทย การวิเคราะห์มุ่งเน้นไปยังกลไก ปัญหา แนวทางการแก้ไขปัญหาของประเทศดังกล่าวเพื่อเฟ้นหาแนวทางที่น่าสนใจอันสามารถที่จะปรับเข้ากับสภาวะการณ์ของธุรกรรมซื้อคืนภาคเอกชนในประเทศไทย

จากการศึกษาดังกล่าว บทความนี้จึงเสนอแนะแนวทางในการวางกรอบทางกฎหมายที่เหมาะสมแก่ธุรกรรมซื้อคืนภาคเอกชน (Private Repo) ในประเทศไทย ได้แก่การเสริมสร้างการรับรองในส่วนของความมีผลของธุรกรรมและการป้องกันความเสี่ยงจากการถูกเปลี่ยนแปลงรูปแบบของธุรกรรม (Recharacterization Risk) โดยแทนที่จะจัดธุรกรรมซื้อคืนภาคเอกชนเข้ากับหลักกฎหมายสัญญาและเอกเทศสัญญา ธุรกรรมซื้อคืนภาคเอกชนได้รับการเสนอให้ได้รับการรับรองคุณลักษณะตามโครงสร้างที่แท้จริง คือเป็นธุรกรรมทางการเงินที่มีการโอนกรรมสิทธิ์ในทรัพย์สินเพื่อบริหารจัดการความเสี่ยง ประการที่สองบทความนี้ได้เสนอให้มีการพิจารณายกเว้นการเก็บภาษีโดยวิธีการหัก ณ ที่จ่ายสำหรับภาษีบางประเภทที่ได้รับการยกเว้น ซึ่งสิทธิประโยชน์ทางภาษีดังกล่าวนี้จะช่วยลดขั้นตอนที่ไม่จำเป็นและประหยัดค่าใช้จ่าย และกระตุ้นให้ผู้ที่สนใจพิจารณาธุรกรรมซื้อคืนภาพเอกชนในฐานะช่องทางหนึ่งในธุรกรรมทางการเงิน ประการที่สาม ในส่วนของการบังคับตามสัญญา ด้วยหนึ่งในวัตถุประสงค์หลักของธุรกรรมซื้อคืนคือการสรรสร้างธุรกรรมทางการเงินที่มีประสิทธิภาพและประหยัดค่าใช้จ่ายและเวลา รวมถึงการบรรเทาความเสี่ยงกฎหมายจึงควรมีความแน่นอนว่ามาตรการในการบังคับตามสัญญานั้นจะสามารถสัมฤทธิ์ผลได้อย่างมีประสิทธิภาพ ทั้งในกรณีการผิดสัญญาหรือกรณีล้มละลาย สำหรับธุรกรรมซื้อคืนภาคเอกชน ประสิทธิภาพดังกล่าวรวมถึงการบังคับจากหลักทรัพย์และข้อตกลงตามสัญญา อาทิเช่น การหักกลบลบหนี้ สุดท้ายนี้ การพัฒนาและปรับปรุงธุรกรรมซื้อคืนจะต้องได้รับความร่วมมือจากทุกภาคส่วน ในการสนับสนุนทั้งด้านทฤษฎีและทางปฏิบัติ อาทิเช่น การส่งเสริมความรู้ความเข้าใน และการสนับสนุนด้านระบบปฏิบัติการข้อผิดพลาดและแนวทางแก้ไขจากประเทศต่างๆ สามารถนำมาศึกษาเพื่อเปรียบเทียบและปรับใช้กับสภาวะการณ์ในประเทศไทยเพื่อให้เกิดการพัฒนาอย่างยั่งยืนสืบไป

คำสำคัญ: ธุรกรรมซื้อคืน, Title Finance, ธุรกรรมทางการเงิน

Introduction

Due to the growing needs and concerns for risk mitigation in financial arrangement, various methods and transactions have been developed by all related parties to secure and assure the confidence that the parties will be satisfied despite the outcome of the arrangement. The typical security transactions include those governed by legislation, such as pledge and mortgage, and those other non-legal-specific arrangement made between the parties. However, there remain problems for both kind of transaction, such as strict requirements the statutory types of security, especially in terms of creation, form, and enforcement procedures which could be quite costly and time consuming. On the contrary, although the complicated requirements are greatly lesser, the unregulated arrangement may result in ineffective enforcement or even unenforceability.

Title finance[1] or title-based financing[2] is a financial arrangement designed to eliminate all these problems. This arrangement offers creditors stronger assurance, since the title of the assets is collateralized in order to put the creditor in a super-priority position. This kind of financing is not new. In fact, it possesses quite the same concept as a well-known sale with the right of redemption, title retention, financial lease, as well as factoring, securitization, and sale and lease-back agreement.

Repurchase agreement (repo) is one of the tools of which the structure can be considered as title finance explained above. In brief, it is a transaction where one party sells securities of their own, to the other party in exchange of fund with the agreement that the first will pay back the fund with additional amount in return of the equivalent securities from the latter. Both parties, therefore, are obligated not only to make payment and transfer the given securities, but also to repurchase at advanced fixed price and transfer the equivalent securities.

A repo transaction generally begins, in the first leg (open leg), when one party sells his assets to another party for a certain price and commits to repurchasing them in future at a different fixed price. The seller delivers the securities and receives cash from the buyer. The buyer then becomes the rightful owner of the transferred securities and is allowed to exercise the right as the owner of the securities to sell them, use them as collateral, or sell them in other repurchase agreement. At the second leg (close leg), the buyer becomes the seller with the obligation to return the equivalent securities,[3] and the seller becomes the buyer who is obliged to pay the repurchase price with an additional sum at a predetermined rate of interest, known as the repo rate, [4] which remains constant during the term of the trade.[5] In the event of default, the general practice of repo offers a convenient and quick enforcing approach for the remedy of the non-defaulting party by set-off or netting, or enforcement from the securities.

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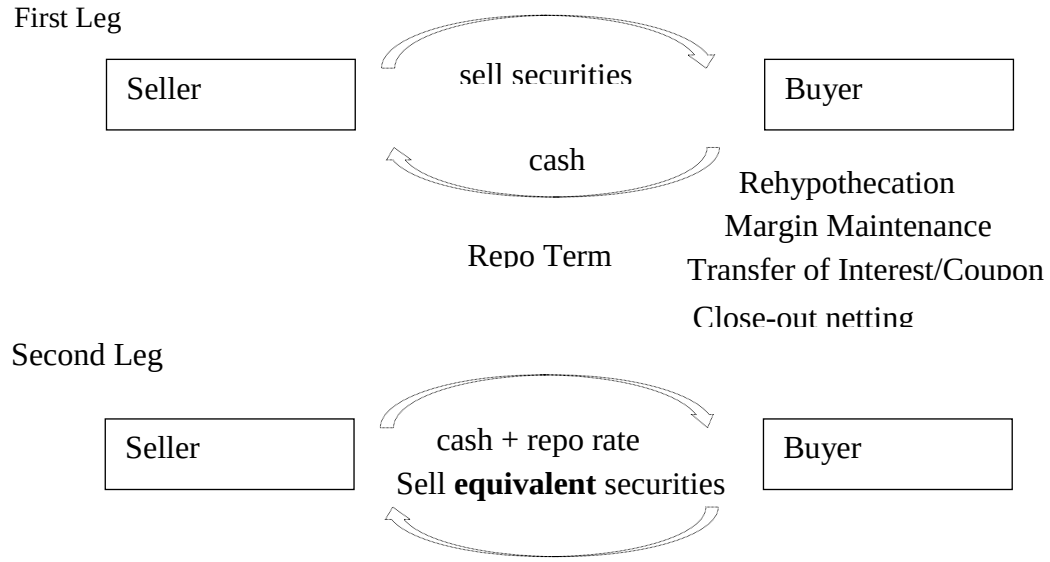
[1] Philip R. Wood, Comparative Law of Security Interests and Title Finance, 675 (2nd ed. 2007).
[2] H. G. Beale, The Law of Security And Title-Based Financing, 270 (2nd ed. 2012).
[3] Under Global Master Repurchase Agreement (GMRA), Equivalent Securities with respect to a transaction means securities equivalent to purchased securities under that transaction. If and to the extent that such purchased securities have been redeemed, the expression shall mean a sum of money equivalent to the proceeds of the redemption.
[4] Wood, *supra* note 1, at 716.
[5] *Id.* at 115.

In addition, one essential concept of repo transactions is their ability to mitigate risk, which not only includes the risk to the buyer if the seller fails to repurchase the securities or, in other words, fails to repay the loan, but also the seller's risk of the buyer's failure to return the securities (which can be equivalent ones).[6]Moreover, since the collateral used in the transaction consists of securities with diversified value, the value must be maintained during the term of the repo to ensure that it remains close to the purchase price. Therefore, repo transactions are subject to mark-to-market[7] in three options, the first of which is allowing the buyer to demand the seller to transfer the margin to maintain the value. The second is repricing by terminating the previous agreement and re-entering into a new agreement, but adjusting the purchase price while retaining the same amount of securities. The third involves replacement by terminating the agreement and making a new one, maintaining the purchase price but adjusting the amount of securities.[8]

The whole transaction is illustrated below.



With the underlying nature, the convenience and reliability, as well as the time and cost saving offered, the practicality and simplicity makes repo a well-established investment product widely used not only by commercial and investment banks, but also by fund managers, corporate treasuries, and local authorities. Repo, as one of title-based financing plays a role in protection against insolvency and cost of credit reduction. Ever since introduced, repo has become one of financial market instruments, and quite an important one. The repo markets in various countries, both developed and developing, is growing fast, largely, and vitally.

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[6] Collateral Initiatives Coordination Forum, *Collateral Fundamentals*, Appendix 7 (2012), available at http://www.icmagroup.org/assets/documents/Regulatory/CICF/Collateral-Fundamentals-7Nov2012.pdf.

[7] Id.

[8]Bank of Thailand, *Private Repurchase Market* (January 30, 2002), https://www.bot.or.th/English/FinancialMarkets/FinancialMarketDevelopment/Related%20Articles/Private%20repurchase%20market.pdf#search=private%2520repo (last visited July 15, 2015).

Repo Transactions in Global Markets

Since the introduction of repo transactions in the United States ("US") in 1918, repo has undergone widespread growth and development all over the world throughout the general agreement under the Global Master Repurchase Agreement (GMRA). The biggest markets are the US and Europe of which the structure and framework will be explained in this study.

1. **Repo Transactions in United States**

The first repo was introduced by the US Federal Reserve in 1918 with the aim of creating the primary instrument for the Federal Reserve Bank open market operation. Repos were used as a tool to manage liquidity in the system. In present, repos principally function as short-term corporate investment in the US. The settlement of interest and the transaction system used therein is the Federal Book Entry and the Federal Reserve Bank acts as the central registrar. In addition, the Federal Reserve Bank participates in the Treasury market to stimulate liquidity and adjust interest rate policy; therefore, the counterparties are mainly primary dealers.[9]

Since its introduction in 1918, the US Treasuries repo market has become the largest in the world with a daily volume of more than $1,000 billion.[10] However, despite its significance, the law on the treatment of repos is scant.[11] There are some regulations regarding securities laws or taxation that regulate repos. The essential legal issues regarding repos are mentioned under laws regarding secured transactions, which are also linked to bankruptcy laws.

2. **Repo Transactions in European Union**

According to the European Repo Market Survey undertaken by the International Capital Market Association ("ICMA"), the total value of repo agreements in the EU is around EUR 5,500 billion. This includes domestic and cross-border trading, 40% of which is conducted via direct business (telephone and electronic messaging), followed by Automatic Repo Trading Systems ("ATS"), voice-brokers, and tri-party respectively.[12]

One of the great obstacles that has hampered financial transactions in the EU since its formation is the variety of rules applicable to collateral in Member States, which has caused the participants more complex and costly problems than necessary. Three remarkable problems are particularly the requirement of perfection, bankruptcy legislation, and the rule of location of securities. Since these problems are related to each other, it is impossible to fix each of them separately, although it may be possible to solve them all together since they are each other's cause and effect.

EU Directive 2002/47/EC on Financial Collateral Arrangement ("EU Directive 2002/47/EC" or "Directive") was prepared as a result of a proposal by the European Commission to simplify the EU legal framework in 2001. The aim of the framework was to

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[9] Moorad Choudhry, The Global Repo Markets : Instruments & Applications, 283 – 284. (2004).
[10] Moorad Choudhry, *The REPO Handbook*, 7 (2nd ed. 2010).
[11] Jeanne L. Schroeder, *Repo Madness: The Characterization Of Repurchase Agreements Under The Bankruptcy Code And The U.C.C.*, 46 Syracuse L. Rev. 1001 (1996), available at http://heinonline.org/HOL/LandingPage?handle=hein.journals/syrlr46&div=34&id=&page=.
[12] ICMA, *European repo market survey Number 28 - conducted December 2014*, (2015), available at http://www.icmagroup.org/assets/documents/Market-Info/Repo-Market-Surveys/No-28-December-2014/ICMA-ERC-European-Repo-Survey-December-2014.pdf.

limit credit risk in financial transactions by the provision of securities and cash as collateral. The Directive establishes a framework to cope with issues that impede and adversely affect the efficient use of collateral, including formal requirements.[13]

3. Repo Transactions in Thailand

Repo transactions in Thailand are currently divided into two segments, using participants and purpose as criteria. The first consists of "Bilateral Repo" transactions conducted between the Bank of Thailand ("BOT") and appointed primary dealers with the objective of exercising the operation of monetary policy, while the second consists of "Private Repo" transactions among firms in the private sector.

Similar to many other jurisdictions in the world, Thailand has no specific legislation that comprehensively governs private repo transactions. There are BOT regulations governing private repo transactions when one of the parties is a commercial bank or financial institution under the Financial Institution Business Act B.E. 2551 (2008) ("Financial Institution Business Act"), regulations of the Securities and Exchange Commission ("SEC") for those securities companies, and a few for taxation issues. However, the law leaves other matters in the hands of general commercial laws. Similar to many other countries, although not as severe, there are inconclusive legal issues that need to be clarified.

Legal Problems and Impediments

Although the development of repo transactions has long been encouraged in Thailand and the growth in the number of such transactions has progressively increased, especially private repos, knowledge is still limited to specific groups. In fact, there is still plenty of room and loopholes that need to be filled for the sustainable development of repo transactions and to make them one of the foremost choices in terms of access to finance. Despite the great effort taken by government authorities, especially the Ministry of Finance, the BOT, the SEC, as well as the Stock Exchange of Thailand ("SET") and bond market-related organizations, several inconclusive matters remain.

To create sustainable development, the mechanisms, problems, and varied resolution approaches taken by the US and EU should be comparatively studied and analyzed in order to find the suitable legal framework to be adopted for repo transactions in Thailand.

1. Characteristics

The first and primary issue concerns the unclear treatment and loopholes that are still varied and dissociated in terms of the characteristics of private repos; for instance, the definitions provided in each related regulation are somewhat inconsistent. In the regulations of the BOT, private repo transactions are defined as "the engagement in securities trading with an agreement to resell or repurchase the securities at a future date for the purpose of lending or borrowing, as the case may be, having a financial instrument as collateral. As

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[13] Directive 2002/47/EC of The European Parliament and of the Council of 6 June 2002 on Financial Collateral Arrangements art. 3 [hereinafter *EU Directive 2002/47/EC*].

such, the private repo transaction is determined similar to credit granting under the Section 4 of the Financial Institution Business Act.[14]

The regulations of the SEC provide no definition of repo transactions for securities companies, but a definition is given in relation to mutual funds, as "the sale of securities or debt instruments with an agreement to repurchase such securities or debt instruments on the specific date agreed."[15] Meanwhile, the tax regulations define private repo transactions as "a transaction agreed by the seller of securities and the buyer of securities under which the seller agrees to sell securities to the buyer with the agreement to repurchase in the future in accordance with the term and price agreed in advance."[16]

These varied definitions raise questions regarding the applicable legal principle, since the regulations provide no practical treatment.

Moreover, to get back to the provisions of general laws, Civil and Commercial Code ("CCC") does not provide enough applicable assurance and certainty. To define each leg as a contract of sale remains uncertainty for repo term enforcement, such as mark-to-market measures; a sale with promise is different from repo in term of revocability and there is no commitment of the promised parties to respond, whilst repo is an agreement that commits both parties to resale and repurchase without exemptions. Repo is not a sale with an agreement to sale as the subject matter is obviously dissimilar between the aim to enter to another sale agreement and the aim to repurchase upon fully agreed terms. And although the structure and mechanism may be familiar, repo is not a sale with right to redemption. This is not only because the repurchasing leg is not a right but obligation, the requirements of the same actual property and the limited period of redemption are not something repo is constructed for.

Besides, although the concept of repo is viewed as more of a loan secured by securities, the interpretation will severely impact and disqualified repo from its main purpose. Seeing repo as loan of money secured by securities pledge will surely raise questions regarding troublesome formal requirements and enforcement procedures.

Hence, it is recommended that repo has its own way of characteristic that would allow the agreed term reach the most effective goal to create one great financial arrangement.

2. Tax Treatments

Despite the promotion and tax incentives given, one of the major problems concerns the withholding of tax. The title of the collateral is fully transferred to the buyer during the term of the repo, but it is normally always provided in the agreement that the buyer must

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[14] Notification of the Bank of Thailand No. SorNorSor 19/2552 Re: Permission for Commercial Banks to Engage in Private Repo Transaction [hereinafter *BOT Notification on Private Repo for Commercial Banks*]; Notification of the Bank of Thailand No. SorNorSor 23/2551 Re: Permission for Finance Company and Credit Foncier Company to Engage in Private Repo Transaction [hereinafter *BOT Notification on Private Repo for Finance Company and Credit Foncier Company*].

[15] Notification of the Office of the Securities and Exchange Commission Regulations No. KorNor 11/2552 Re Criteria, Conditions, and Methods of Money Borrowing by Mutual Fund and Asset Commitment of Mutual Fund [hereinafter *SEC Notification on Private Repo for Mutual Fund No. KorNor 11/2552*]

[16] Royal Decree Regarding Exemption from Revenue Taxes (No.364) B.E.2542 (1999) sec. 3 [hereinafter *Royal Decree Regarding Exemption from Revenue Taxes (No.364)*].

transfer any interest or coupons received during the repo term in the full amount. However, from a taxation perspective, the buyer is deemed to be the owner of the collateral during the term, and the one who receives such interest or coupons from the securities issuer; therefore, the buyer is subject to withholding tax upon receipt. Even though this withholding of tax deducted can be applied to a tax return at the end of the year, most participants view this as a great legal impediment that discourages them from choosing a private repo transaction as the primary option.

3. Enforcement

Due to the lack of a solid practical legal approach, uncertainty is caused by alternative measures applied to manage the risks of the transaction, such as mark-to-market, margin maintenance, as well as close-out netting provisions. Although these measures are designed to facilitate the effective remedy of any damage that may be incurred due to the default or insolvency of the party, there are no solid legal approvals, which results in an ineffective imposition or even invalidity. For example, a question may be raised of whether these alternatives could stand against the creditor protection principle. For instance, without lawful assurance, mark-to-market and margin maintenance may raise the question of whether it is a fraudulent act to the creditor under Section 237 of the CCC, or Section 90/40, Section 113, and Section 114 of the Bankruptcy Act, as the case may be.[17]

4. Operation System

The engagement of the transaction remains substantially inflexible. Certain procedural requirements are non-essential.[18] For example, the complexity of standard agreements, securities assessment, and margin maintaining management are still troublesome for some potential participants, especially those who are not familiar with financial arrangements. Related impeding factors include the readiness of a transaction supporting system, in-depth knowledge and understanding of investors, as well as of the related staff or authorities.

As a result of the aforementioned factors, despite the tremendous potential of repos, participants in the private repo market remain limited to financial institutions and there has been inadequate expansion to other groups of investors, whose assets have excess liquidity.

Comparative Analysis and Recommendations

Private repo transactions can currently only respond to the need of certain large primary dealers to manage their excess liquidity, yet they remain unable to respond to need for a liquidity arrangement of certain large to medium institutions due to the inflexibility of the transactions, which is of primary concern. Therefore, this article proposes that the laws

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[17] วรรณรัตน์ จันทร์แสงทอง, *ปัญหาทางกฎหมายเกี่ยวกับการประกอบธุรกรรมซื้อคืนหลักทรัพย์* (2546) (วิทยานิพนธ์, จุฬาลงกรณ์มหาวิทยาลัย) (Wannarat Jansangtong, *Legal Problems Concerning Repurchase Transaction*, 103-106 (2003) (Master of Laws Thesis, Chulalongkorn University)).

[18] ศิริดาว สง่าเมือง, *การศึกษาตลาดซื้อคืนพันธบัตรภาคเอกชนในประเทศไทย* (2552) (การศึกษาค้นคว้าอิสระ, มหาวิทยาลัยเกษตรศาสตร์) (Siridow Sangamuang, *Study of Private Repurchase Market in Thailand*, 52 (2009) (Independent Study, Kasetsart University)).

and regulations should be amended to become more united under the same standard, especially for the material issues, which should be clarified as explained below.

1. Characteristics

The clarity of the transaction has an extremely significant impact on the performance and the result, especially in the event of enforcement. Many jurisdictions have different opinions and treat these transactions differently. In Thailand, the regulations regarding repos are quite unsettled. While the BOT defines a private repo as a sale of securities with an agreement to repurchase with the underlying intention to acquire a loan secured by securities of a similar nature to a credit-granting service, the SEC leaves a repo transaction undefined. Additionally, the confusing factors that seem to point to the nature of true sale include the intention of the parties that engage in the transaction for funding or liquidity, the transfer of title of the collateral, and the requirement to sell back the equivalent securities.

Despite the theoretical argument, instead of trying to push the transaction into a specific category of contract, as the US treats repos by making them neutral and characterizing the transaction differently on a case by case basis, there is another option to treat the transaction as it is. Just like the treatment used in the EU Directive, it would be better if the policy was set and designed to admit the fact that a repo is just a financial agreement in which the title of asset is fully and legally transferred to facilitate risk management for both parties. In this way, repos will not be required to conform to formal legal requirements in order to ensure their validity. In other words, the laws will be framed so that repos are treated and considered as if they have been structured for neither a true sale nor a secured loan. Thus, the non-compliance with existing laws, the rehypothecation, or the return of different but equivalent assets will not invalidate the enforceability of the transaction.

2. Tax Treatment

Being aware that a private repo transaction is not exactly an outright sale, but rather a way to access finances, the Revenue Department of Thailand has tried to support such transactions by providing exemptions for income tax, specific business tax, and stamp duty. However, one of the impediments concern the duty of the repo buyer (lender) to not only return the full manufactured interest to the original owner of the collateral, but to remain obliged to withhold tax upon receipt of such interest. Although the sum withheld can be credited at the end of the year, the potential buyer or lender, who has excess liquidity, seriously considers this issue and may decide to avoid engagement due to the costs and expense.

This is also a problem faced in other markets. In the EU, some member states provide exemption for manufactured interest/coupon withholding tax in case of repo or financial arrangement that constitutes short-term loan, e.g. UK, Austria. However, in the US the problem is not considered and substitute dividends made pursuant to a securities lending or a repo would be subject to US withholding tax at a rate of 30 per cent.[19]

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[19] Freshfields Bruckhaus Deringer LLP, *Dividend Taxation For Cross-Border Transactions* (March 2012), available at http://www.freshfields.com/uploadedFiles/SiteWide/Knowledge/Dividend%20taxation%20for%20cross-border%20transactions.pdf.

Hence, when designing as policy that can reflect the laws and regulations, the authorities should consider exempting the withholding of tax for private repo transactions. This will not only eliminate an unnecessary procedure and save costs, but it will also encourage those who have an excess of assets to consider investing in private repo transactions to manage their liquidity and those in need of money can access funding from a wider channel via a private repo.

3. Enforcement

Repos, as one approach to financing by title transfer, provide the creditor with the ability to directly enforce his right of the debt from the collateral given to him without any conditions or requirements that are so burdensome that they may cause him to hesitate to provide the finance in the first place. However, the principle of unsecured creditor protection is why the law creates enforcement formalities and requirements to ensure that the creditor who facilitated the debtor without any securities will also be facilitated when it comes to the default or insolvency of the debtor. This is why the imposition of fraudulent acts would prejudice other creditors' right.

It is a one great concern that repo is one important financial product, and its facilitating enforcement methods should not be disapproved. EU Directive 2002/47/EC ensures the effectiveness of mutually agreed arrangement by requiring that methods of enforcement agreed by the parties must be realizable.[20] In the US, although the characteristic issues are left undealt, aware that such hole could hamper the effectiveness of enforceability, the bankruptcy code has exempt repo from automatic stay and allowing the enforcement outside bankruptcy court.[21]

Hence, for Thailand, a clear line should be made to determine which creditors are fraudulent and which just want to be assured, and since a repo transaction is an arrangement in which the title of collateral is transferred, the law should constitute certain assurance of effective enforcement and adjust unnecessary inflexibility in financial transaction, not just by selling out, but also by other practical means agreed, such as close-out or netting. The assurance of enforceability includes the endorsement of title transfer collateral, and the process of debt settlement should not be viewed as an impediment to protect unsecured creditors.

4. Operation System

Another leading problem of private repo transactions in Thailand concerns the knowledge and understanding of the transaction procedure. The complexity of the transaction includes the standard agreement, in which many conditions are required to be met, and the need for an in-depth understanding of the principles. For example, in order to mitigate risk, the transaction has been structured by certain measures to ensure the equal value between the sale price and the collateral, known as margin maintenance. The requirement of coupon transfer and the withholding of tax, the obligation regarding clearing and settlement, the

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[20] EU Directive 2002/47/EC, *supra* note 13 art. 4 and art. 7

[21] Bankruptcy Code §§ 362(b)(6), (7), (17), & (27); § 553(b)(1); §§ 555-556, §§ 559-562; see also Steven L. Schwarcz & Ori Sharon, *The Bankruptcy-Law Safe Harbor for Derivatives:A Path-Dependence Analysis*, 71 Washington & Lee Law Review (forthcoming), (November 12, 2013), available at http://scholarship.law.duke.edu/faculty_scholarship/3151.

management of collateral and the dispute resolution in cases of default all require an effective system, and this is too heavy a burden, even for large commercial banks to establish a back office to operate the transaction on their own, let alone other kinds of organizations. The Thailand Securities Depository Co., Ltd ("TSD"), a subsidiary of the SET, is currently providing a repo service to facilitate transactions. However, the number of users and members of the service remain limited[22] and most of them are commercial banks and securities companies who also receive other kinds of services from the TSD.

In view of the foregoing, the operational system should be improved and the concept of a collateral management service offered by the TSD could be a great example of such improvement. Policy-makers may establish an official office for the collateral management of the private repo market or improve the service provided by the TSD. Either way, the operational system of private repo transactions should be capable of satisfying investors by saving costs, with expert staff to attract investors and expand the market to other non-bank participants.

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