

## THE ENFORCEABILITY OF INSOLVENCY CLOSE-OUT NETTING ARRANGEMENTS UNDER EUROPEAN COMMUNITY LAW<sup>1</sup>

### 1. Introduction

This note examines the enforceability of insolvency close-out netting provisions contained in bilateral master agreements for swap, derivative, foreign exchange, repurchase and securities lending transactions required under various European Community (EC) legal acts, including (a) Council Regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings<sup>2</sup> (the “Insolvency Regulation”); (b) Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements<sup>3</sup> (the “Collateral Directive”); and (c) Directive 2001/24/EC of the European Parliament and of the Council of 4 April 2001 on the reorganisation and winding up of credit institutions<sup>4</sup> (the “Winding-up Directive”).

While this body of EC legislation may be expected to enhance, in some respects, the enforceability of insolvency close-out netting arrangements under the laws of the existing 15 European Union (EU) Member States, there is already a considerable body of national legislation recognising the enforceability of insolvency close-out netting in almost all of the Member States.<sup>5</sup> Draft legislation recognising the enforceability of insolvency close-out netting arrangements is also currently under preparation in Greece.<sup>6</sup>

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<sup>1</sup> Prepared by Niall Lenihan, with research assistance from Elena Galan, ECB.

<sup>2</sup> Official Journal of the European Communities (“Official Journal”), L 156, 29.06.2000, p. 3.

<sup>3</sup> Official Journal L 168, 27.06.2002, p. 43.

<sup>4</sup> Official Journal L 125, 5.5.2001, p. 15.

<sup>5</sup> **Austria:** Bankruptcy Code (*Federal Law Gazette 1924/337*) as amended; Banking Act (*Federal Law Gazette 1993/532*) as amended; **Belgium:** Law of 22 March 1993 on Credit Institutions; **Denmark:** Securities Trading Act, Lbleg 2002-07-09, num 587; **Finland:** Act on certain conditions of Securities and Currency Trading as well as Settlement Systems (26.11.99/1084); **France:** Monetary and Financial Code, *Code Monétaire et Financier*, du 14.12.2000; **Germany:** Code of October 5, 1994 Insolvency Code (*Insolvenzordnung*) Entered into force January, 1, 1999 (BGBl. I. S. 2866); **Ireland:** Netting of Financial Contracts Act, 1995, supplemented by the Netting of Financial Contracts Act, 1995 (Designation of Financial Contracts) Regulations, 2000; **Italy:** Decree-Law Num. 58/1998 (*Testo Unico delle disposizioni in materia di intermediazione finanziaria*); **Luxembourg:** Law of 6 of May of 1996 on the set off of claims and debts of the Financial Sector, as amended; **Netherlands:** Bankruptcy Act of 1893, as amended (*Faillissementswet*). Civil Code, Book 6, Chapter 12 (*Burgerlijk wetsboek*); **Portugal:** Decree-Law No. 1/97 of 7.01.1997 (Regula a aceitação pelo Estado das cláusulas de compensação, denominadas "netting" e "set-off", no âmbito de acordos sobre produtos financeiros derivados, celebrados nos mercados financeiros) Decree-Law Num 70/97 of 03.04.199; **Spain:** Securities Market Law 37/1998 (*Ley del Mercado de Valores*) as amended by Law 44/2002 of 22 November 2000; and **Sweden:** Financial Instruments Trading Act (SFS 1991:980). Bankruptcy Act (1987:672). In **England & Wales** the enforceability of netting is widely accepted without the need for specific statutory recognition.

<sup>6</sup> Draft Greek legislation on bond issues and securitisations was published in November 2002. The legislation contains an article providing for the enforceability, in case of bankruptcy or other collective proceedings, of the netting of counter-claims, including close-out netting, in (a) transactions between parties one of whom is a credit institution or an investment services firm or (b) over-the-counter derivatives transactions.

This note has therefore been prepared with a particular focus on the recognition of insolvency close-out netting arrangements in the 10 EU Accession States scheduled to accede to the EU on 1 May 2004 (Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia and Slovenia), many of whose laws do not currently recognise insolvency close-out netting arrangements. Legislation recognising insolvency close-out netting has been passed, or is under discussion, in a number of these ten EU Accession States. Annex 1 to this note sets out a very preliminary summary of the recognition of insolvency close-out netting arrangements under the laws of the ten EU Accession States. It is intended to supplement this information as and when English language translations or explanations of any netting legislation adopted or under consideration in the EU Accession States become available.

## **2. Insolvency Regulation**

The Insolvency Regulation entered into force on 31 May 2002, and is directly applicable in all existing 15 EU Member States<sup>7</sup> except Denmark.<sup>8</sup> The Insolvency Regulation will enter into force in the 10 EU Accession States at the moment of their EU accession on 1 May 2004. The Insolvency Regulation applies to collective insolvency proceedings which entail the partial or total divestment of a debtor and the appointment of a liquidator, but does not apply to insolvency proceedings concerning insurance undertakings, credit institutions, investment undertakings which provide services involving the holding of funds or securities for third parties, or to collective investment undertakings.<sup>9</sup> For the purposes of the Regulation, insolvency and winding-up proceedings means the proceedings listed in Annexes A and B of the Regulation, which identifies the specific insolvency proceedings covered by the Regulation in each of 13 EU Member States.<sup>10</sup> The Council, acting by qualified majority on the initiative of one of its members or on a proposal from the Commission, may amend the Annexes.<sup>11</sup> Logically, these Annexes need to be amended to identify the specific insolvency proceedings covered by the Regulation in each of the ten new EU Member States upon their Accession to the EU.

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<sup>7</sup> Under Article 44(3) of the Insolvency Regulation, the Regulation shall not apply: (a) in any Member State, to the extent that it is irreconcilable with the obligations arising in relation to bankruptcy from a convention concluded by that State with one or more third countries before the entry into force of the Regulation; or (b) in the United Kingdom of Great Britain and Northern Ireland, to the extent that it is irreconcilable with the obligations arising in relation to bankruptcy and the winding-up of insolvent companies from any arrangements with the Commonwealth existing at the time the Regulation enters into force.

<sup>8</sup> As noted in the thirty third recital to the Insolvency Regulation, Denmark, in accordance with Articles 1 and 2 of the Protocol on the position of Denmark annexed to the Treaty on European Union and the Treaty establishing the European Community, is not participating in the adoption of the Regulation, and is therefore not bound by it nor subject to its application.

<sup>9</sup> See Insolvency Regulation, Article 1.

<sup>10</sup> See Insolvency Regulation, Article 2(a) & Annex A.

<sup>11</sup> See Insolvency Regulation, Article 45. As noted in the thirty fifth recital to the Insolvency Regulation, as these Annexes relate exclusively to the legislation of Member States, there are specific and substantiated reasons for the Council to reserve the right to amend these Annexes in order to take account of any amendments to the domestic law of the Member States.

Under Article 6 of the Insolvency Regulation it is provided that the opening of insolvency proceedings shall not affect the right of creditors to demand the set-off of their claims against the claims of the debtor, where such a set-off is permitted by the law applicable to the insolvent debtor's claim, except, however, that this shall not preclude actions for voidness, voidability or unenforceability (the law of the State of the opening of proceedings shall continue to determine the rules relating to the voidness, voidability or unenforceability of legal acts detrimental to all the creditors).<sup>12</sup>

Article 6 of the Insolvency Regulation should allow set-off to be a guaranteed remedial right for a creditor irrespective of the insolvency laws of a jurisdiction that is unfriendly to set-off. However, two qualifications regarding the utility of this provision have been noted by the law firm of Clifford Chance in a note regarding netting issues arising from the Insolvency Regulation.<sup>13</sup> *First*, 'set-off' is rather narrower than netting. A netting agreement will typically provide for close-out (or acceleration) of the transactions or obligations of the parties as well as for set-off of the resulting amounts. Close-out may itself be vulnerable to challenge under some systems of insolvency law. As noted by Wood, insolvency set-off may only be available in certain jurisdictions (e.g., Greece) if the cross-claims are connected or if they arise in the same current account.<sup>14</sup> The protection given by Article 6 probably does not go so far as to shield the non-defaulting party from that sort of challenge. Clifford Chance concludes that it is advisable that in those jurisdictions where automatic termination provisions are currently required (e.g., Belgium), such automatic termination provisions continue to be used with entities that are subject to the Insolvency Regulation. *Second*, it is noted that set-off must work under the law applicable to the defaulting party's claim against the non-defaulting party. Where a netting agreement is used it is possible that the law applicable to individual transactions is different from the governing law of a netting agreement.

### **3. Collateral Directive**

The Collateral Directive entered into force on 27 June 2002 and both the existing 15 EU Member States and the 10 EU Accession States are required to bring into force the laws, regulations and administrative provisions necessary to comply with the Directive by 27 December 2003 at the latest.<sup>15</sup> The Collateral Directive applies to financial collateral arrangements in which the collateral taker and the collateral provider must each belong to one of a number of specific categories, generally covering public authorities, central banks, multilateral development banks, specified supranational institutions, financial institutions subject to prudential supervision (including credit institutions, investment firms,

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<sup>12</sup> See Insolvency Regulation, Article 4(2)(m).

<sup>13</sup> See Clifford Chance, Netting issues arising from the European Insolvency Regulation and Winding up Directive (August 2001).

<sup>14</sup> See Philip R. Wood, Title Finance, Derivatives, Securitisations, Set-off and Netting (Sweet & Maxwell 1995), p. 162.

<sup>15</sup> See Collateral Directive, Article 11, first para.

insurance undertakings and UCITS), central counterparties, settlement agents and clearing houses.<sup>16</sup> Where one party to a financial collateral arrangement falls into one of these specified categories and the other party is a non-natural person (including unincorporated firms and partnerships), Member States have an option to include or exclude such a financial collateral arrangement from the scope of the Directive.<sup>17</sup>

Under Article 7 of the Collateral Directive Member States are required to ensure that a close-out netting provision can take effect in accordance with its terms, notwithstanding (a) the commencement or continuation of winding-up proceedings<sup>18</sup> or reorganisation measures<sup>19</sup> in respect of the collateral provider and/or the collateral taker; and/or (b) any purported assignment, judicial or other attachment or other disposition of or in respect of such rights.<sup>20</sup> In particular, Member States are required to ensure that the operation of a close-out netting provision may not be subject to any of the following requirements: that (a) prior notice of the intention to realise must have been given; (b) the terms of the realisation be approved by any court, public officer or other person; (c) the realisation be conducted by public auction or in any other prescribed manner; or (d) any additional time period must have elapsed.<sup>21</sup> For purposes of the Directive, a ‘close-out netting provision’ means a provision of a financial collateral arrangement, or of an arrangement of which a financial collateral arrangement forms part, or, in the absence of any such provision, any statutory rule by which, on the occurrence of an enforcement event, whether through the operation of netting or set-off or otherwise: (i) the obligations of the parties are accelerated so as to be immediately due and expressed as an obligation to pay an amount representing their estimated current value, or are terminated and replaced by an obligation to pay such an amount; and/or (ii) an account is taken of what is due from each party to the other in respect of such obligations, and a net sum equal to the balance of the account is payable by the party from whom the larger amount is due to the other party.<sup>22</sup> A ‘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.<sup>23</sup> A ‘title

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<sup>16</sup> See Collateral Directive, Article 1(2).

<sup>17</sup> See Collateral Directive, Articles 1(2)(e), 1(3).

<sup>18</sup> For this purpose, ‘winding-up proceedings’ mean collective proceedings involving realisation of the assets and distribution of the proceeds among the creditors, shareholders or members, as appropriate, which involve any intervention by administrative or judicial authorities, including where the collective proceedings are terminated by a composition or other analogous measure, whether or not they are founded on insolvency or are voluntary or compulsory. See Collateral Directive, Article 1(j).

<sup>19</sup> For this purpose, ‘reorganisation measures’ mean measures which involve any intervention by administrative or judicial authorities which are intended to preserve or restore the financial situation and which affect pre-existing rights of third parties, including but not limited to measures involving a suspension of payments, suspension of enforcement measures or reduction of claims. See Collateral Directive, Article 1(k).

<sup>20</sup> See Collateral Directive, Article 7(1).

<sup>21</sup> See Collateral Directive, Article 4(4).

<sup>22</sup> See Collateral Directive, Article 2(1)(n).

<sup>23</sup> See Collateral Directive, Article 2(1)(a).

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.<sup>24</sup> A '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.<sup>25</sup>

Taken together, the above provisions require Member States to ensure the enforceability of close-out netting provisions contained in any master agreement under which exposures are collateralised by way of title transfer or pledge arrangements, including master repurchase and securities lending agreements, as well as master swap agreements of which a financial collateral arrangement forms part (e.g., an ISDA Master Agreement of which an ISDA Credit Support Annex or Deed forms part). Member States are also required to ensure the enforceability, as a matter of, e.g., national insolvency law, of any statutory rules providing for netting or set-off.

#### **4. Winding-up Directive**

The Winding-up Directive entered into force on 5 May 2001 and both the existing 15 EU Member States and the 10 EU Accession States are required to bring into force the laws, regulations and administrative provisions necessary to comply with the Directive by 5 May 2004. Member States are required to forthwith inform the Commission of the entry into force of these laws, regulations and administrative provisions and to communicate to the Commission the texts of the main provisions of national law which they adopt in the field governed by the Directive.<sup>26</sup> The Winding-up Directive applies to credit institutions and their branches set up in Member States other than those in which they have their head offices.<sup>27</sup>

The Winding-up Directive contains two provisions relating to set-off and netting.

Article 23 of the Winding-up Directive provides that the adoption of reorganisation measures<sup>28</sup> or the opening of winding-up proceedings<sup>29</sup> shall not affect the right of creditors to demand the set-off of

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<sup>24</sup> See Collateral Directive, Article 2(1)(b).

<sup>25</sup> See Collateral Directive, Article

<sup>26</sup> See Winding-up Directive, Articles 34(1), first para., and 34(3).

<sup>27</sup> See Winding-up Directive, Article 1(1).

<sup>28</sup> For this purpose, 'reorganisation measures' mean measures which are intended to preserve or restore the financial situation of a credit institution and which could affect third parties' pre-existing rights, including measures involving the possibility of a suspension of payments, suspension of enforcement measures or reduction of claims. See Winding-up Directive, Article 2.

<sup>29</sup> For this purpose, 'winding-up proceedings' mean collective proceedings opened and monitored by the administrative or judicial authorities of a Member State with the aim of realising assets under the supervision of those authorities, including where the proceedings are terminated by a composition or other, similar measure. See Winding-up Directive, Article 2.

their claims against the claims of the credit institution, where such a set-off is permitted by the law applicable to the credit institution's claim (provided, however, that this shall not preclude actions for voidness, voidability or unenforceability of legal acts detrimental to all the creditors).

Article 25 of the Winding-up Directive provides that netting agreements shall be governed solely by the law of the contract which governs such agreements. Three possible interpretations have been suggested regarding the interpretation of this provision.

*First*, it has been suggested that the provision expresses a mere truism, repeating the tautology that a netting agreement is governed by the law of the contract that governs such agreements. However, this interpretation appears unsustainable as it would render the provision utterly meaningless. Such an interpretation of Article 25 of the Winding-up Directive would be contrary to the principle of Community law applied by the Court of Justice that a legal provision must be interpreted in such a manner that its implementation is effective and useful.<sup>30</sup> Moreover, the use of the word 'solely' implies that the law of the contract applies to the exclusion of another potentially relevant legal system. In view of the traditional relevance of insolvency law in assessing the validity of insolvency close-out netting arrangements, it can only be concluded that the provision deliberately departs from the general principle contained in the Winding-up Directive that a credit institution shall be wound-up, and reorganisation measures shall be applied, in accordance with the laws, regulations and procedures applicable in its home Member State.<sup>31</sup> This interpretation is also supported by a teleological interpretation, having regard to the legislative policy underlying the provision.<sup>32</sup> Article 25 of the Winding-up Directive was absent from earlier versions of the draft Directive proposed by the Commission and considered by the European Parliament. The first draft of Article 25 was introduced when the Council established a common position on the Directive on 17 July 2000. In the Statement of the Council's reasons for the introduction of this provision, the Council clarified that "[t]his Article derogates from the basic principle of the application of the law of the Home Member States.... The overall objective of this Article to ensure legal certainty in particular cases where it is thought that the importance or the special nature of the contract justifies the derogation from the principle of universality. Paragraphs 1c) and d) concern contractual netting agreements (agreements to set off positive and negative balances) between a credit institution and its counterparty and repurchase agreements (an agreement between a seller and a buyer of securities where the seller agrees to

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<sup>30</sup> See Jean-Pierre Degué, Advisor – Belgian Banking and Finance Commission, Directive 2001/24/EC on the reorganisation and winding up of credit institutions finally establishes uniform private international law for banking insolvency proceedings, International Conference on Bankruptcy Reform, Siena, 6-7 December 2000, p. 14.

<sup>31</sup> See Winding-up Directive, Articles 3(2) and 10(1). For this purpose, 'home Member State' means the Member State in which a credit institution has been authorised in accordance with Articles 4-11 of 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, *Official Journal L 126, 26.5.2000, p.1*, as defined in Article 1 (6) of said Directive. See Winding-up Directive, Article 2.

<sup>32</sup> As noted by Judge Kutscher, the difficulties of interpretation arising from the multilingual nature of Community law are frequently resolved not through a grammatical interpretation but by resorting to an examination of the objects of the provision. See H. Kutscher, *Methods of Interpretation as seen by a Judge at the Court of Justice*, Judicial and Academic Conference 27-28 September 1976, p. 20.

repurchase the securities at an agreed price) respectively. In both cases the law of the Member State applicable to the agreement applies. Such agreements are commonly used on the financial markets and the Council considers that the especial function of such contracts requires a derogation from the principle of universal application of home Member State law in order to protect the functioning of the financial markets and to ensure legal certainty for the contracting parties.”<sup>33</sup>

*Second*, it has been suggested that Article 25 of the Winding-up Directive means that, upon the formal insolvency of a party to a netting agreement, the only applicable law in relation to that netting agreement would be the law of the contract, irrespective of where the insolvency proceedings were being held or the particular rules of any applicable system of insolvency law. The selection of a governing law provision from a netting friendly jurisdiction should therefore ensure netting even if the counterparty is incorporated in a netting-unfriendly jurisdiction.<sup>34</sup> This would have potentially far-reaching consequences. Much EU netting legislation forms part of national insolvency and bankruptcy codes, and in some cases specifies in some detail the terms and conditions under which the enforceability of insolvency close-out netting should be recognised. This interpretation would appear to imply, so far as a credit institution is concerned, that such netting legislation contained in insolvency or bankruptcy codes is no longer relevant in any way to a determination of the validity of the netting agreement where the netting agreement is governed by the law of a jurisdiction other than the credit institution’s home state. For example, the rather elaborate Irish Netting of Financial Contracts Act 1995 would no longer be relevant to a determination of the enforceability of a netting agreement governed by English law executed by an Irish-incorporated credit institution. The same would pertain to credit institutions in any EU Member State whose home country insolvency code contains intricate legislation specifying the terms and conditions under which insolvency close-out netting is enforceable.

*Third*, it has been suggested that insolvency law may still be relevant to the validity of a netting agreement in that, under Article 25 of the Winding-up Directive, the effects of insolvency proceedings on a netting agreement will be determined exclusively by the law governing the said agreement, even if it is the law of a non-Member State of the European Community (e.g., New York law).<sup>35</sup> This interpretation would appear to imply, so far as the validity of a netting agreement against a credit institution is concerned, that netting legislation contained in insolvency or bankruptcy codes might still be relevant to a determination of the validity of the netting agreement insofar as such netting legislation is contained in the insolvency or bankruptcy codes of the jurisdiction whose laws govern

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<sup>33</sup> See Common position EC No 43/2000 adopted by the Council on 17 July 2000 with a view to adopting Directive 2000/.../EC of the European Parliament and of the Council of... on the reorganisation and winding-up of credit institutions, Official Journal C/2000/300.

<sup>34</sup> See Clifford Chance, Netting issues arising from the European Insolvency Regulation and Winding up Directive (August 2001).

<sup>35</sup> See Jean-Pierre Deguée, Advisor – Belgian Banking and Finance Commission, Directive 2001/24/EC on the reorganisation and winding up of credit institutions finally establishes uniform private international law for banking insolvency proceedings, International Conference on Bankruptcy Reform, Siena, 6-7 December 2000, p. 14.

the contract. Such an interpretation could have unusual consequences. For example, the validity of a netting agreement governed by New York law that is executed by an EU-incorporated credit institution could be determined by reference to the netting provisions applicable to US depository institutions. Indeed, taking account of the fact that banks in the United States are chartered under both federal and state laws, such an interpretation could prove very difficult to apply.

It would seem that the second interpretation is the only feasible interpretation of Article 25 of the Winding-up Directive, notwithstanding the consequences mentioned above.

It is also noted that Article 25 of the Winding-up Directive does not define the concept of 'netting'. It has been suggested that, for this purpose, netting covers both bilateral and multilateral netting agreements.<sup>36</sup> It might even be argued that the term 'netting' potentially covers cross-affiliate netting arrangements. However, it is suggested that this would be an ambitious interpretation, and that a more realistic interpretation may be that the essential characteristic of netting should be understood as referring to the essentially bilateral process of close-out, conversion of obligations into monetary claims and mutual set-off.

#### **5. Issues for discussion by EFMLG members**

- Do EFMLG members consider that any of the provisions of Community law regarding the enforceability of insolvency close-out netting provisions merit further clarification?
- Do EFMLG members consider that the implementation of the netting provisions of the Collateral and Winding-up Directives in (a) the existing 15 EU Member States and (b) the 10 Accession States should be closely monitored by the EFMLG?
- Do EFMLG members consider that the EFMLG should convey any views to the Commission with respect to these matters?

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<sup>36</sup> See *id.*



## ANNEX 1

### THE RECOGNITION OF INSOLVENCY CLOSE-OUT NETTING ARRANGEMENTS IN THE 10 EU ACCESSION STATES

Legislation recognising close-out insolvency netting has been passed, or is under discussion, in a number of the ten EU Accession States scheduled to accede to the EU on 1 May 2004. The information set out below is very preliminary, and it is intended to supplement this information as and when English language translations or explanations of any netting legislation adopted in the 10 EU Accession States become available. It is noted that the International Swaps and Derivatives Association (ISDA) is closely monitoring these developments in a number of the 10 EU Accession States (e.g., the Czech Republic, Hungary, Poland and Slovakia).<sup>37</sup>

**Cyprus:** While further clarification is necessary, it is understood that insolvency close-out netting may be valid and may not be set aside by an administrator, provided the netting does not occur within six months prior to the commencement of the proceedings and does not constitute a fraudulent preference. No legal texts are available, and further clarification and follow-up is necessary.

**Czech Republic:** The Czech Republic adopted insolvency close-out netting legislation with the adoption of a provision in the Czech Securities Act in September 2000 which provides for the enforceability of close-out netting provisions in netting agreements. However, the effectiveness of this provision has been undermined by certain ambiguous wording in the legislation suggesting that close-out netting may only be performed by securities dealers. It is understood that legislation designed to remove this ambiguity and strengthen the enforceability of insolvency close-out netting has been introduced into the Czech Parliament. Further information is available from the International Swaps and Derivatives Association.

**Estonia:** It is understood that the Estonian Bankruptcy Code provides that the ordinary rules for the set-off of claims do not apply to the mutual claims of a creditor and a debtor which arise between the parties from financial, banking or securities transactions which are performed in the course of their usual economic activities on the basis of one and the same contract and the content of which are the mutual obligations of the same type between the creditor and the debtor. It is understood that the set-off of such obligations is permitted on the basis of a petition of one of the parties at all times after the

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<sup>37</sup> The information provided by Peter Werner of the International Swaps and Derivatives Association's European office regarding the recognition of insolvency close-out netting in four of the EU Accession States (the Czech Republic, Hungary, Poland and Slovakia) is gratefully acknowledged.

commencement of the bankruptcy proceeding, and that the set-off enters into force pursuant to the conditions of the contract between the parties. No legal texts in English are available and further clarification and follow-up is necessary.

**Hungary:** Hungary adopted insolvency close-out netting legislation with the adoption of the Hungarian Act CXX of 2001 on the Capital Markets, which entered into force on 1 January 2002. Under the Capital Markets Act the Hungarian Bankruptcy Act was amended to provide for the enforceability of close-out netting pursuant to a close-out netting agreement arising from spot foreign exchange and securities transactions, derivative transactions, repos or reverse repos, securities lending or other similar financial transactions. Notwithstanding this recognition of insolvency close-out netting, only licensed Hungarian banks or local branches or subsidiaries of non-Hungarian banks may provide investment services (including the conduct of derivatives activities) under the Capital Markets Act, which has limited the cross-border effectiveness of this legislation to date. As from the moment of Hungary's accession to the EU on 1 May 2004, EU banks will be able to provide investment services into Hungary. An English translation of the Capital Markets Act is available to ISDA members, and ISDA has commissioned a netting opinion from external Hungarian legal counsel.

**Latvia:** It is understood that insolvency close-out netting is not permissible under Latvian law upon the commencement of insolvency proceedings.

**Lithuania:** It is understood that insolvency close-out netting is not recognised under Lithuanian law. It is understood that the Civil Code contains general provisions on set-off and novation, which also apply to liabilities secured by collateral. It is understood that a court might recognise netting agreements when approving the plan of settlement with creditors if a reasoned legal argumentation is submitted. No legal texts in English are available and further clarification and follow-up is necessary.

**Malta:** The Set-off and Netting on Insolvency Act, 2003 (Act IV of 2003) was signed into law in Malta earlier this year, and entered into force on 1 June 2003. The legislation is in English and is available on request. The legislation provides in broad terms for the enforceability of set-off and netting on bankruptcy or insolvency, including close-out netting provisions in any contract. The legislation provides for the enforceability of such netting against the parties to a contract, any guarantor, specified insolvency officials and the creditors of the parties. The legislation does not restrict the enforceability of insolvency close-out netting to specified categories of persons (e.g., financial institutions).

**Poland:** It is understood that bankruptcy legislation was passed by both Houses of Parliament in late February 2003 and was signed into law very recently by the President of Poland. It is understood that the legislation is not intended to enter into force until 1 October 2003. While an English translation of the text of the legislation is not yet available, it is understood that the legislation considerably extends the circumstances in which the enforceability of close-out insolvency netting will be recognised under Polish law. In particular, it is understood that the legislation recognises the enforceability of insolvency close-out netting arrangements with respect to both Polish and foreign companies and both financial and non-financial institutions. Further information is available from the International Swaps and Derivatives Association.

**Slovakia:** While it is understood that there is no legislation recognising the enforceability of insolvency close-out netting, legislative efforts are underway with the Slovak Government to ensure the passage of netting legislation. Further information is available from the International Swaps and Derivatives Association.

**Slovenia:** It is understood that insolvency set-off is allowed until the day of the beginning of the insolvency proceedings. The position regarding the recognition of close-out netting is unclear. No legal texts in English are available, and further clarification and follow-up is required.