

MemberNet

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Subject: *7th Meeting of the LFS WG
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ITEM 6 OF THE AGENDA: *NETTING*

Members at the meeting will be invited to comment the document and give the Secretariat guidelines to elaborate further a possible proposal for a Directive

Please find enclosed a document referring to the possible adoption of a Directive at EU level addressing the issue of netting, elaborated by KBC.

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Enclosure: 1

Outline of a Directive on Close-out Netting Arrangements (the 'Netting Directive')

KBC Position paper

I. Subject matter and scope

- (a) In their position paper, ISDA and EFMLG, limit their proposal for a netting directive to 'close-out netting' which is understandable since the ISDA contracts mainly deal with this type of netting. We feel however that the netting directive should have a much larger scope and deal with both **set-off and all types of bilateral and multilateral netting** identified in the Angell report. Specifically with regard to set-off, a harmonisation measure would be more than welcome particularly in the light of article 6 of the European Insolvency Regulation which gives an (undue) advantage to creditors who have contracted under a law which favours set-off in case of concourse (such as English law).
- (b) Furthermore, the netting directive should clarify through what type of legal mechanisms the different types of netting can take place (set-off, novation, ...).
- (c) We agree that the personal scope of the directive should not exclude natural persons it being understood that we would not object to certain protective measures being introduced for consumers.
- (d) It is very important that the scope of the netting directive is not limited to set-off and netting agreements that are accessory to a financial collateral arrangement but also encompasses autonomous netting clauses and agreements.
- (e) The netting directive should deal with both the validity and the perfection of the set-off and netting arrangements, particularly in case of insolvency, reorganisation measures or any other type of concourse.

- (f) As far as the set-off and netting of receivables is concerned, the netting directive should clarify what characteristics the receivables should have to benefit from the protection offered by the netting directive. Issues that should be addressed are for instance:
- Whether the receivables should pertain to money or the same interchangeable assets ?
 - Is multilateral set-off conceivable?
 - Should the receivable be due before it can be set-off or netted ?
 - Should set-off or netting after concourse, be limited to receivables that already existed at the time of the concourse? What is an existing receivable ?
- (g) We do not feel that the scope of the netting directive should be limited to certain types of transactions so that defining the covered transactions in an annex is not our preferred approach. Any type of set-off or netting arrangement should be included in the scope of the netting directive, regardless of the type of transaction (derivatives transaction, commercial finance, consumer finance, factoring, insurance, securities lending,) in which such arrangement is embedded.
- (h) Ideally, the Settlement Finality Directive would be incorporated in the netting directive.

II. Definitions

- (a) Instead of adapting the definitions of the netting directive to those used in the Collateral Directive, we feel that the definitions used in the netting directive, the Collateral Directive and the Settlement Finality Directive should be equated with those used in the Insolvency Regulation which in our opinion should work as the benchmark in view of its being directly applicable in each member state.
- (b) The netting directive should provide for a definition of 'set-off', 'netting', 'close-out', 'close-out event' and 'close-out arrangement'.
- (c) The netting directive should also provide for a definition of 'concourse'.

III. Formal requirements for validity and perfection

We concur with and fully support the position taken in the ISDA/EFMGL paper.

IV. Enforceability of set-off and netting arrangements in case of 'concourse'

- (a) The netting directive should ensure that the set-off or netting can be operated without the requirements of any prior actions such as a notice or a court approval.
- (b) The netting directive should deal with the effect of an assignment of one or more of the receivables that are the object of the set-off or netting arrangement. We are not in favour of the solution that set-off or netting can take effect even after an assignment since this is very detrimental to factoring, forfaiting, discounting operations, etc.
- (c) It should be ensured that set-off and netting can be operated notwithstanding any attachment (*beslag/saisie*) on any of the receivables that are to be netted. It should be clarified here that the set-off and netting can take effect without any additional requirement (such as connexity).
- (d) It should be ensured that the set-off or netting can take effect notwithstanding the commencement or continuation of insolvency proceedings (such as bankruptcy, winding up,...) or reorganisation proceedings (such as administration, collective redress, voluntary liquidation,...) without any additional requirement (such as connexity)
- (e) It should be ensured that neither the set-off or netting arrangement nor the set-off or netting executed on the basis thereof, can be void or voidable on the basis that they took place during a certain 'suspect period' prior to the commencement of a insolvency proceeding.
- (f) There is still a lot of uncertainty with regard to the enforceability of set-off or netting when one or more of the transactions or receivables that are to be netted only came into existence after the commencement of a insolvency proceeding or concourse. Preferably this issue should also be addressed in the netting directive.

V. Enforceability of close-out provision in case of concourse

- (a) Close-out netting does not constitute one, separate legal mechanism but is the combination of two separate mechanisms, namely netting on the one hand and 'close-out' on the other hand. Consequently, it should be clarified what type of insolvency proceedings can (or cannot for reasons of consumer protection) constitute a close-out event.
- (b) The netting directive should cover both automatic and optional close-out.

VI. Certain insolvency provisions disapplied

We agree with the position taken by ISDA and EFMLG.

VII. Conflict of laws

Overview of the 'acquis communautaire'

The current conflict of law rules are currently scattered over the following provisions which are not always consistent:

- a. Article 6 of the Insolvency Regulation which stipulates that the opening of an insolvency proceeding 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.
- b. Article 8 of the Settlement Finality Directive which stipulates as follows: *"In the event of insolvency proceedings being opened against a participant in a system, the rights and obligations arising from, or in connection with, the participation of that participant shall be determined by the law governing that system"*.
- c. Article 9 of the Insolvency Regulation which contains a rule similar to that of article 8 of the Settlement Finality Directive.
- d. Article 23 of the Winding Up Directive 2001/24/EG which provides for a similar rule as article 6 of the Insolvency Regulation.

- e. Article 25 of the Winding Up Directive 2001/24/EG where it is stipulated that *“Netting agreements shall be governed solely by the law of the contract which governs such agreements.”*
- f. Article 22 of the Winding Up Directive 2001/17/EC which provides for a similar rule as article 6 of the Insolvency Regulation.

(j) The netting directive

- (a) The netting directive should introduce a European conflict of law rule with respect to the validity of set-off and netting. Currently, such a conflict of law rule is only provided for in article 25 of the Winding Up Directive but it needs to be considered whether the conflict of law rule provided there is the most appropriate.
- (b) The netting directive should provide for a clear conflict of law rule regarding the enforceability in case of concurrence of set-off and netting operated by way or law or on the basis of a netting agreement. This conflict of law rule should be consistent with the Insolvency Regulation.
- (c) Since the ‘close-out’ is a separate legal mechanism, the netting directive should also provide for a specific conflict of law rule regarding the validity and the enforceability of ‘close-out’ clauses.

Brussels, 28 March 2008

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