

La Directrice générale

Paris, 7th, august 2008

French Banking Federation position on the ISDA & EFMLG proposal for a European Netting Directive

Dear Mr Wright,

We are writing on behalf of the French Banking Federation¹ in connection with the ISDA & EFMLG proposal for a European Netting Directive.

On April 24th, 2008, the ISDA and EFMLG addressed a common letter to the European Commission (the **ISDA/EFMLG Letter**) containing a proposal for a European Netting Directive in the context of the project from the Commission to amend jointly the Financial Collateral Directive and the Directive 98/26/EC on settlement finality (the "**Finality Directive**").

We welcome the work that the Commission is undertaking in the context of amending the Financial Collateral and Finality Directives and we are also working on this project.

We note the ISDA/EFMLG Letter outlines that, despite this quality work, there "*is certainly room for further progress, in particular where the personal and material scope of the Financial Collateral Directive and the protection of close-out netting are concerned*". The ISDA/EFMLG Letter also underlines the necessity to have a high degree of legal certainty on the enforceability of contractual close-out netting arrangements and the fact that Directive 2006/48/EC (the **Banking Directive**) explicitly requires that credit institutions when using contractual netting arrangements – as well as competent authorities – must be satisfied that netting is legally valid and enforceable under the laws of each relevant jurisdiction.

Mr. David WRIGHT
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¹ It is important to underline that the position sets out in ANNEX is the result of a joint work between the French Banking Federation and several French and international law firms of Paris Financial Place (the "**Working Group**").

The ISDA/EFMLG Letter stresses that it is feasible to provide legal certainty by enacting a new Netting Directive and we are in agreement with this.

We would however like to draw your attention to our comments on the proposals in the ISDA/EFMLG Letter, as set out in the Annex to this letter, in particular two points:

- the paramount importance of linking the material scope and personal scope in order to avoid an unnecessarily restricted material scope if the personal scope is too wide, and *vice versa*;
- the necessity of harmonising the conflict of law treatment of winding-up procedures on a general level and not only with reference to the Winding-up Directive. This is a major issue as conflict of law only exists if the European Law is not harmonised.

As the purpose of the proposed Netting Directive is to harmonise this, the Working Group is reserved on the conflict of law recommendation of the ISDA/EFMLG Letter and would not support it as this is contrary to the objectives. However, if the European Laws are not sufficiently harmonised despite the proposed Netting Directive, the parties to an agreement should then be able to freely choose the applicable law of one of the European States as applicable law to the agreement.

We would be pleased to discuss our position further with you or your staff and to answer any question you may have.

Best regards,

yours

Ariane Obolensky

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Netting Directive proposal – Comments from the FBF Working Group

Draft of proposal contained in the IDSA/EFMLG letter	Comments from the FBF Working Group
Subject matter and scope	
<p>The Netting Directive should apply to bilateral close-out netting arrangements and the transactions entered into thereunder.</p>	<p>The scope has to cover both OTC transactions and multilateral trading facilities. Besides, the transactions should not only cover the agreements but also reciprocal obligations.</p>
<p>To the extent not covered by the Finality Directive, it should also cover multilateral close-out netting arrangements, e.g. those provided for by multilateral trading facilities.</p>	<p>No specific comments.</p>
<p>The coverage of close-out netting arrangements should be as broad as possible and include close-out netting arrangements where one or both parties are natural persons. For the sake of legal certainty and a level playing field in the internal market, there should be no elective derogations ('opt-outs') from the scope of persons covered by the Netting Directive.</p>	<ul style="list-style-type: none"> - The Working Group is favourable to the netting for transactions entered between a natural person and a financial institution (<i>Prestataire de Service d'Investissement</i>). - However, the Working Group considers that the netting for transactions between two natural persons is not necessary due to the fact that (i) there is no real systemic risk, (ii) the practical interest is limited and (iii) this can be a sensitive political issue. - The Working Group strongly supports the cancellation of "opting out" possibilities. Nevertheless, the implementation of the Directive should be carefully driven in order to obtain an equivalent effect in the various jurisdictions.

¹ The FBF's Netting Directive Working Group groups together French and international banks and major French and international business law firms.

Netting Directive proposal – Comments from the FBF Working Group

<p>The covered transactions should be defined in a separate Annex to the Netting Directive. The definition should be broad in order to cover all types of transactions irrespective of the type of underlying and of whether the relevant transaction is exchange traded or concluded 'over the counter' or whether cash settlement or physical settlement is agreed. The definition should also be broad enough to cover foreseeable future market developments.</p>	<ul style="list-style-type: none"> - As a general point, the Working Group considers that it is of a paramount importance to link the material scope and personal scope in order to avoid a too restricted material scope if the personal scope is too extended, and vice versa.
<p>For avoidance of doubt, the Annex to the Netting Directive should not refer to Section C of Annex I of the Directive 2004/39/EC on markets in financial instruments, because the terms introduced therein serve different purposes and also do not cover the full range of financial market exposures that are currently subject to close-out netting arrangements.</p>	<ul style="list-style-type: none"> - The lists could be different if the concepts are common. However, the same definitions should be used for identical products. - It is important and necessary for the Working Group to refer to "financial obligation" for transactions between "eligible counterparties" as a list is not necessary in this case.
<p>It should be clarified) that the inclusion in any close-out netting arrangement of any transaction not listed in the Annex to the Netting Directive should not affect the application of the Netting Directive.</p>	
<p>The Netting Directive should clarify in relation to a multi-branch entity (which would typically be a bank) that the enforceability of close-out netting against the multi-branch entity in the jurisdiction of the main proceedings (in relation to a non-bank company) or home country proceedings (in relation to a bank or insurance undertaking) should not be affected by the laws of any jurisdiction where a branch of that entity might be located (whether that branch is located in a Member State or otherwise).</p>	<p>It is agreed concerning EU States but, concerning non EU States, this should normally not have to apply to branches established outside EU.</p>

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Definitions	
<p>Some of the definitions used under the Netting Directive could be borrowed from the Financial Collateral Directive.</p> <p>Examples are the terms 'winding-up proceedings' and 'reorganisation measures', which for sake of consistency of the <i>acquis communautaire</i> should have the same meaning.</p> <p>New definitions are, however, necessary.</p> <p>Examples are the terms 'close-out event' and 'close-out netting arrangement', which in the context of netting have to be construed differently.</p>	<p>The Working Group agrees to the extent that it is necessary to avoid or minimize divergent definitions.</p> <p>No specific comments.</p>
Formal Requirements	
<p>The Netting Directive should ensure that the validity and enforceability or the admissibility in evidence of a close-out netting arrangement of transactions governed by it are not dependent on the performance of any formal act.</p> <p>Formal acts include, amongst other requirements, registration, notarisation or the provision of a 'certain date'.</p>	<p>- The Working Group would like to cancel the reference to confirmations as the Directive should apply to Master agreements and not to the confirmations modalities.</p> <p>- Netting provisions has no direct link with proof methods or forms. This is under the competence and the legislation of each member State law and has nothing to do with a Netting Directive.</p> <p>This is an important point.</p>

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<p>The Netting Directive should be applicable to all close-out netting arrangements and transactions, which can be evidenced in writing or in <u>an</u> a legally equivalent manner. As far as transactions are concerned, a legally equivalent should also cover trades that have been concluded legally and that are evidenced by tape recordings or statement of a witness only or otherwise and transactions concluded via electronic platforms or systems.</p>	<p>- Again, a netting Directive should not have to cover the proof methods. Hence, the second part of the sentence referring to the transactions should be deleted.</p> <p>- It is also necessary to cancel the reference to transactions and "legally" and to refer to existing references such as "durable support".</p>
<p>Enforceability of close-out netting arrangements</p>	
<p>The Netting Directive should ensure that, on the occurrence of a close-out event, the close-out netting arrangement comes into effect and is enforceable as provided in the terms agreed therein.</p>	<p>No specific comments.</p>
<p>The Netting Directive should specify examples of events or actions that should not constitute a requirement for the enforceability of the close-out netting arrangement.</p>	<p>No specific comments.</p>
<p>Specified examples should include (i) prior notices of the intention to terminate and close-out; (ii) approvals of a court, public officer or other person and (iii) the determination of current values, costs or losses as of a prescribed date or point in time or in a prescribed manner.</p>	<p>No specific comments.</p>
<p>It should be ensured that close-out netting arrangements can take effect notwithstanding the commencement or continuation of winding-up proceedings or reorganisation measures or any purported assignment, attachment or other disposition of or in respect of the close-out netting arrangement.</p>	<p>No specific comments.</p>

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Netting Directive proposal – Comments from the FBF Working Group

<p>The Netting Directive should ensure that covered transactions are not void or voidable or otherwise unenforceable just by reason of a law relating to gaming or gambling.</p>	<p>This should normally not be covered by a Netting Directive. This is however an important point to be definitely clarified at the European Law level.</p>
<p>Certain insolvency provisions disapplied</p>	
<p>The Netting Directive should ensure that any transfer of cash, financial instruments or commodities under the close-out netting arrangement or any transaction should not be declared invalid or void on the sole basis that the transfer was made on the day of the commencement of winding-up proceedings or reorganisation measures in a prescribed period prior to the commencement of such proceedings.</p>	<ul style="list-style-type: none"> - A global approach on harmonisation of the winding-up procedure over the existing Directives is necessary. - The Working Group recommends to include a general exclusion not linked to specific references (winding-up procedures). - The references to the provisions of the Payment Finality Directive should be also included by a cross-reference.
<p>It should also be provided that the operation of a close-out netting arrangement shall not be affected by any moratorium, stay, freeze or any decree or order with a similar effect made by any administrative or judicial authority or liquidator or similar official.</p>	<ul style="list-style-type: none"> - For this point and the others hereunder, it is necessary to harmonise the conflict of law treatment regarding the winding-up procedures on a general basis and not only referring to the Winding-up Directive. - This is a major stake. Conflict of law only exists if the European Law is not harmonised. A conflict of law treatment is only necessary if the material law is not harmonised. As the purpose of the Directive is to harmonise this; the Working Group is reserved on this conflict of law recommendation and would not support it as this is contrary to the objectives.
<p>Conflict of laws</p>	
<p>The Netting Directive should ensure that all questions arising in relation to the enforceability of a close-out netting arrangement shall be governed solely by the substantive EU civil law chosen by the parties of the close-out netting arrangement.</p>	

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<p>The relevant matters governed by such laws should be explicitly named, including (i) the legal nature of a close-out netting arrangement and (ii) the requirements and legal steps necessary to render a close-out netting arrangement and the transactions thereunder effective and enforceable.</p>	<p>- However, if the European Laws are not sufficiently harmonised despite the Directive, the parties to an agreement should then be able to freely choose the applicable law of one of the European States as applicable law to the agreement. This is also linked to the possibility to get a Master Agreement available in the major Laws of the EU.</p>
<p>Once the Netting Directive provides for appropriate conflict of law rules applicable to all close-out netting arrangements, Article 25 of the Directive 2001/24/EC on the reorganisation and winding up of credit institutions¹ (the 'Winding-up Directive') could be deleted. If the Commission decides to maintain Article 25 of the Winding-up Directive, it should at least further clarify the term 'netting' as well as the aspects outlined above preferably by, to the extent possible, applying the same terminology and formulations as those intended for the Netting Directive.</p>	
<p>The Netting Directive should be formulated in a conclusive manner so as to avoid any possibility of conflicting application of the Rome I² Regulation" e.g. by referring to the principle of 'lex specialis'.</p>	

¹ 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 (OJ L125, 5.5.2001, p. 15).

² Regulation (EC) n° [...]2008 of the European Parliament and of the Council of [...] on the law applicable to contractual obligations (Rome I) (not yet published in the OJ).

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