

# Harmonisation of Close-out Netting Rules

**Pedro Ferreira Malaquias**

**Frankfurt am Main, 21 October 2009**

## I – Introduction

- Directive 2006/48/EC (the “Banking Directive”) explicitly requires that credit institutions and competent supervisory authorities must be satisfied that netting under contractual netting arrangements is legally valid and enforceable under the laws of each relevant jurisdiction.

- CONCEPTS

(Payment) Netting is the process by which amounts due in the same currency on the same day between financial market counterparties are reduced to a single net balance for settlement purposes.

Close-out netting is the process by which mutual obligation between financial market counterparties are reduced to a single net balance following a termination event, including a default by one of the parties.

- Several EU financial instruments contain provisions on netting.
- “Today, the principle of close-out netting is well established in all Member States, but it remains to be seen how these netting provisions are applied in practice” – European Commission – Evaluation Report on the Financial Collateral Arrangements Directive - 20 December 2006.

## **II – Need for Harmonisation**

### **I. Regulatory Level**

- Close-out netting typically may face the opposition of insolvency laws, certain debtors protection laws, gaming laws and, in some cases, general principles of contract law.
- The existent netting legislation in the various jurisdictions is not harmonised.
- A new Netting Directive would provide legal certainty to the markets.

- Some of the main outlines of such Netting Directive may be summarised as follows:
  - broad coverage;
  - definitions;
  - no formal requirements;
  - enforceability;
  - conflicts of law.

## **2. Contractual level (maxime in standard market documentation**

- Lessons drawn from the financial turmoil – High-level Legal Symposium of September 15, 2009
  - Events of default
  - Termination Notices
  - Automatic Early Termination
  - Calculation of Close-out Amounts
  - Collateral and Margin Dispute Resolution

### 3. The way forward

- at legislative level
- at standard market documentation level