

**Outline of a draft proposal for a Directive on Close-Out Netting  
Arrangements  
(the 'Netting Directive')**

**Subject matter and scope**

- The Netting Directive should apply to bilateral close-out netting arrangements and the transactions entered into thereunder.
- 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.
- 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.
- 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.
- 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<sup>1</sup>, 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.
- 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.
- 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

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<sup>1</sup> Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC (OJ L145, 30.4.2004, p.1).

be located (whether that branch is located in a Member State or otherwise).

## **Definitions**

- Some of the definitions used under the Netting Directive could be borrowed from the Financial Collateral Directive.
- Examples are the terms ‘winding-up proceedings’ and ‘reorganisation measures’, which for sake of consistency of the *acquis communautaire* should have the same meaning.
- New definitions are, however, necessary.
- Examples are the terms ‘close-out event’ and ‘close-out netting arrangement’, which in the context of netting have to be construed differently.

## **Formal requirements**

- The Netting Directive should ensure that the validity and enforceability or the admissibility in evidence of a close-out netting arrangement or transactions governed by it are not dependent on the performance of any formal act.
- Formal acts include, amongst other requirements, registration, notarisation or the provision of a ‘certain date’.
- The Netting Directive should be applicable to all close-out netting arrangements and transactions, which can be evidenced in writing or in a legally equivalent manner. As far as transactions are concerned, ‘legally equivalent’ should also cover trades that have been concluded orally and that are evidenced by tape recordings or statement of a witness only or otherwise and transactions concluded via electronic platforms or systems.

## **Enforceability of close-out netting arrangements**

- 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.
- 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.
- 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.

- 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.
- 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.

### **Certain insolvency provisions disapplied**

- 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.
- 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.

### **Conflict of laws**

- 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 civil law chosen by the parties of the close-out netting arrangement.
- 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.
- 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 institutions<sup>2</sup> (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.

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<sup>2</sup> 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).

- The Netting Directive should be formulated in a conclusive manner so as to avoid any possibility of conflicting application of the Rome I Regulation<sup>3</sup>, e.g. by referring to the principle of 'lex specialis'.

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<sup>3</sup> 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).