



**EUROPEAN COMMISSION**

Directorate General Internal Market and Services

**FINANCIAL SERVICES POLICY AND FINANCIAL MARKETS**  
**Financial markets infrastructure**

Brussels, 10 December 2010  
DG MARKT/RW/lbv D(2010) 1031487

**DISCUSSION PAPER FOR THE 1<sup>ST</sup> MEETING OF THE**  
**CLOSE-OUT NETTING**  
**MEMBER STATES WORKING GROUP**  
**17 December 2010**  
**LEGISLATION ON CLOSE-OUT NETTING**

## PURPOSE

1. This paper considers the extent to which the legal framework for *close-out netting* allows for the recognition and enforceability of close-out netting agreements, and the case for suspending enforceability in tightly prescribed circumstances in order to secure financial stability. This issue is important for financial stability. First, it could 'hamper the effective implementation of resolution measures' aimed e.g. at the rescue of systemically important financial institutions. Second, it has been suggested that close-out netting can result in insufficient aggregate credit monitoring being undertaken.
2. The introductory section of the paper broadly defines close-out netting and sets out its main advantages and disadvantages. The second section then considers the key EU legal instruments which apply to it and some of the potential problems they give rise to<sup>1</sup>. The subsequent section considers the general issues which must be agreed upon, in order for a consistent approach to such problems with individual legal instruments, to be pursued coherently. The next steps in the group's work are then presented in the final section.

## INTRODUCTION

3. The term close-out netting describes the process leading to the set-off of more than one transaction between counterparties when payment and delivery obligations are not yet mature and due. Upon a termination event experienced by one of the parties (e.g. its insolvency), close-out netting entails:
  - The immediate termination or the acceleration of contracts which are not yet mature ;
  - The valuation of the respective exposures ;
  - The subsequent set-off of the resulting mutual obligations to arrive at one net amount ;
  - The obligation on the party who owes this net amount to pay its counterparty.
4. Close-out netting is relevant for a large proportion of derivatives, repurchase contracts ("repos") and stock lending agreements. Their effect is to reduce parties' bilateral exposures significantly. For example<sup>2</sup>, global OTC derivatives positions amounted to \$583tn at end-June 2010, 15% above the amount at end-June 2007. This total gave rise to 'gross market values' (the cost of replacing all open contracts at current market prices) - a measure of counterparty risk - of \$25tn. However, gross credit exposures after enforceable netting arrangements, amounted to only \$3.6tn, a reduction of some 85% of the related gross market values.

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<sup>1</sup> Drawing on several European Financial Market Lawyers Group submissions including its October 2004 report on 'Protection for bilateral insolvency set-off and netting agreements under EC law'

<sup>2</sup> See BIS data (16 November 2010) at [http://www.bis.org/publ/otc\\_hy1011.htm](http://www.bis.org/publ/otc_hy1011.htm)

5. Enforceable close-out netting reduces one party's bilateral exposure to a counterparty with which it has a close-out netting agreement<sup>3</sup> from the sum of those component transactions in which it is 'in the money', to its net position on all transactions. It thus reduces both its credit risk; and its transaction costs (e.g. the cost of credit lines and margin collateral against gross exposures).
6. Since collateral is normally calculated on a net portfolio basis, close-out netting also results in a much lower amount of collateral being posted, than if it was based instead on the gross exposure on individual transactions.
7. In the case of regulated financial institutions, prudential requirements can be reduced considerably. In particular, banks' capital requirements against credit risk are substantially lower than they would be against their gross exposures (by around \$500bn in mid-2009 on one estimate<sup>4</sup>) and they are less constrained by large exposure ceilings. In addition, close-out netting reduces the constraints imposed on bank balance sheets by proposed leverage ratios. Reflecting these effects, the reduction in banks' credit risk as a result of close-out netting increases their capacity to lend and thus finance economic activity.
8. Close-out netting can mitigate systemic risk by sharply reducing the impact of one party's failure on its solvent, systemically important counterparties (including Central Counterparties (CCPs)<sup>5</sup>), and thus the risk of subsequent contagion. Reflecting this, in March 2010, the Banking Committee on Banking Supervision of the BIS recommended that "*jurisdictions should promote the use of risk mitigation techniques that reduce systemic risk and enhance the resiliency of critical financial or market functions during a crisis or resolution of financial institutions. These risk mitigation techniques include enforceable netting agreements, collateralisation, [...]. Such risk mitigation techniques should not hamper the effective implementation of resolution measures*".<sup>6</sup>
9. However, the impact of close-out netting on the position of 'other' creditors of a defaulting counterparty to a close-out netting agreement must also be considered. Their position in insolvency may deteriorate given the reduced amount of assets available to unsecured creditors; similarly, 'other' creditors may be impacted by

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<sup>3</sup> Close-out netting provisions would normally be part of "master agreements". For cross-border use, the International Swaps and Derivatives Association (ISDA) Master Agreement is the quasi-standard for derivatives transactions from the global perspective, whereas repurchase agreements are bundled either under the International Capital Market Association (ICMA) Global Master Repurchase Agreement or the multi-product European Master Agreement for Financial Transactions (EMA) of the European Bank Federation. Master agreements are not tied to any one particular applicable law, but English or New York law is often chosen for cross-border agreements. The European Master Agreement was geared from the outset to multi-jurisdictional (and multilingual) use and is concluded under the laws of a Member State of the European Union.

<sup>4</sup> See P 6 of ISDA research note on the Importance of Close-out Netting <http://www.isda.org/researchnotes/pdf/Netting-ISDAResearchNotes-1-2010.pdf>

<sup>5</sup> The importance of CCPs is set to increase given widespread official recognition of their contribution to financial stability.

<sup>6</sup> Basel Committee on Banking Supervision, "Report and Recommendations of the Cross-border Bank Resolution Group", March 2010 <http://www.bis.org/publ/bcbs169.pdf>

the potential triggering of termination clauses ahead of insolvency. Moreover in either case, information on the total assets potentially extractable by the solvent counterparties of a particular counterparty is not disclosed (so that close-out netting entails what amounts to an unpublished 'security interest'); however, inferences can be made, reflecting e.g. the repo data reported in a firm's accounts, on the assumption that such business will generally be subject to close-out netting. Moreover, published information on other forms of 'security interest' are generally not available.

10. Close-out netting could raise systemic concerns. First, it could 'hamper the effective implementation of resolution measures' aimed e.g. at the rescue of systemically important financial institutions. Therefore the European Commission suggested in October 2010<sup>7</sup> that there should be provision for a temporary stay on rights to close-out netting where the authorities transfer relevant contracts as a part of a resolution measure and that further consideration be given to the exercise of close-out rights in connection with early intervention measures.
11. Second, it has been suggested that close-out netting can result in insufficient aggregate credit monitoring being undertaken. This could happen because it could erode the credit monitoring incentives for (i) parties to close-out netting agreements, without (ii) other creditors being able to increase their own monitoring (given the dearth of information on exposures to (i)). In addition, close-out netting may encourage unstable funding structures (involving repos etc) and precipitate early bank runs/ contagion (as market-wide positions are closed out early and collateral sold off at fire-sale prices). However, this could also apply to certain exposures which lie outside the scope of close-out netting agreements.

***Do Member States experts agree with this broad account of the role and importance of close-out netting?***

## **EU LAW**

12. In order for netting agreements to be effective, they must be recognised and enforceable under the relevant jurisdiction. At the EU level, the enforceability has essentially been addressed in two different ways.

### **The "conflict-of-laws" approach**

13. Under a "conflict-of-laws" approach, the relevant EU measures define which national law/legal regime will determine whether and under what conditions, netting (close-out netting and/or set-off) may be enforceable. This is the approach of the Insolvency Regulation, the Banking Winding-up Directive and the Insurance Winding-up Directive. This approach does not protect/ring-fence netting agreements as such; rather it relies on the often contradictory approaches of Member States law on this issue, tempered by a reliance on the law of the

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<sup>7</sup> See Communication on 'An EU Framework for Crisis Management in the Financial Sector' [http://ec.europa.eu/internal\\_market/bank/docs/crisis-management/framework/com2010\\_579\\_en.pdf](http://ec.europa.eu/internal_market/bank/docs/crisis-management/framework/com2010_579_en.pdf) (P 10)

contract. This approach gives different results depending on the law applicable to any given situation.

14. The **Insolvency Regulation** (Regulation 1346/2000) provides that the conditions under which "set-off" (which is similar to close-out netting) may be invoked are determined by the law of the insolvency. This will normally be the law of the State where the insolvent has its centre of main interest (Article 4 (2) (d)). However, creditors have the right to demand the set-off of their claims if the law applicable to the claim of the insolvent debtor (e.g., not the law of the insolvency but the law of the relevant contract) provides for insolvency set-off (Article 6). The combination of these two provisions seem to indicate that, even if the law on insolvency does not allow it, set-off will be enforceable if the law of the contract so provides.
15. Second, the enforceability of set-off is limited in that the Regulation allows rules on voidness, voidability or the unenforceability of legal acts detrimental to all the creditors under the law of the insolvency to continue to apply. Thus a creditor's request to set-off based on contract might be refused on the basis of the avoidance rules of the insolvency. Avoidance rules are common in insolvency laws and aim at the recapture of assets transferred by the insolvent entity during a pre-insolvency suspect period (when it knows that the insolvency is looming) in order e.g. to defraud its creditors, or make a preferential payment or transfer for the benefit of one of its creditors to the detriment of the rest.<sup>8</sup>
16. The **Bank Winding-up Directive** (Directive 2001/24/EC) covers close-out netting (on the basis of its reference to netting arrangements) adopts a similar "conflict-of-laws" approach by defining the law that will determine whether set-off and netting will be valid and enforceable in insolvencies. The rules in the Directive as regards set-off (Articles 10 (2) (c), and 23) are the same as in the Insolvency Regulation, while Article 25 provides that netting shall be governed solely by the law of the contract which governs such agreements.

### The "substantive law" approach

17. Under the "substantive law" approach, the enforceability of close-out netting and set-off is imposed directly by EU law which ring-fences, to a large extent, contractual set-off from national insolvency laws. Under this approach, the protection of netting is based directly on EU law and supersedes any national law to the contrary.
18. The **Settlement Finality Directive** (Directive 98/26/EC) protects "netting" of transfer orders against the insolvency of the participants in multilateral payment and securities settlement systems. It focuses mainly on settlement cycles, rather than long-term contractual arrangements.
19. The **Financial Collateral Arrangements Directive** (Directive 2002/47/EC) focuses on the protection of secured (i.e. collateralised) transactions and bilateral netting. Pursuant to Article 7, *"Member States shall ensure that a close-out*

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<sup>8</sup> See Ph. Wood, in "Set-off and Netting, Derivatives, Clearing Systems", Thomson 2007

*netting provision can take effect in accordance with its terms (a) notwithstanding the commencement or continuation of winding-up proceedings or reorganisation measures in respect of the collateral provider and/or the collateral taker; and/or (b) notwithstanding any purported assignment, judicial or other attachment or other disposition of or in respect of such rights."*

It clearly defines a category of contracts and a category of counterparties which are covered by it, and then ring-fences their close-out netting arrangements from the application of national insolvency provisions. In other words, Member States are required to ensure that netting and collateral arrangements are effective on the occurrence of an enforcement event, i.e. an event that the parties have agreed will give rise to a right to terminate, value and net transactions between them. In that respect the Directive provides comprehensive protection for close-out netting.

20. When the Commission evaluated the Financial Collateral Arrangements Directive in 2006, it observed that the principle of close-out netting was well established in all Member States, but that it remained to be seen how these netting provisions are applied in practice. Given the relatively limited experience with the Financial Collateral Arrangements Directive, the Commission merely referred to suggestions to improve the coherence of EU legislation on netting and to expand the material scope beyond the collateral arrangements, but did not elaborate on them, advocating a more comprehensive review of the various netting provisions<sup>9</sup>
21. In particular, suggestions have been made in respect of the following features of the Directive, mostly relating to its scope:
  - The Directive only applies to agreements between counterparties belonging to a specific type, mainly state and regulated entities (e.g., credit institutions, investment firms, insurance undertakings, UCITS, CCPs etc). Member States can, nonetheless, extend the scope of, and hence the protection provided by the Directive to agreements entered into between qualified entities and any other legal person (e.g. corporates) ;
  - It only covers netting provisions contained either in financial collateral arrangements or in arrangements of which a financial collateral arrangement forms part ;
  - The protection of close-out netting against insolvency does not extend to avoidance rules. Thus insolvency law rules that provide for the voidness of collateral arrangements made to e.g. defraud the insolvent party's other creditors are maintained ;
  - The Directive leaves a wide area outside its scope, in the sense that it will not apply if collateral is not involved. It is also debatable whether it applies to agreements under which exposures are capable of being collateralised by way of title transfer or pledge arrangements, despite the parties not having actually provided any collateral ;

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<sup>9</sup> For the same reason, Directive 2009/44/EC amending the Settlement Finality Directive and the Financial Collateral Arrangements Directive did not alter their netting provisions.

- It would seem uncertain whether a netting provision which is contained in an ad-hoc netting master agreement, but not in the collateral agreements themselves, would qualify under the Directive. Moreover, even if there are collateral and netting provisions in each agreement, it does not seem that the Directive would protect/ring-fence the cross-netting between all these unconnected arrangements.
22. Lastly, it has been argued that the implementation of the Financial Collateral Arrangements Directive into Member States' laws has led to a great diversity amongst netting regimes within the EU. This lack of consistency results in high costs for legal opinions determining under which requirements close-out netting is enforceable in a local insolvency<sup>10</sup>. A uniform netting regime across the EU would not only improve efficiency, but it would also raise the global attractiveness of the European market for the rest of the world.

*Do Member States experts concur with the view that "netting" is by now a well established principle under EU/national law and recognised by national courts?*

## **KEY ISSUES REGARDING EU LAW ON CLOSE-OUT NETTING**

23. In reflection of the need to ensure a robust and efficient legal framework for financial markets and the important role played by close-out netting within this, it is timely to reconsider its treatment under EU law. The focus is on enhancing legal certainty regarding the enforceability of close-out netting (including regarding the limitations appropriate for the pursuit of financial stability). In order to this, it is important to adopt a consistent approach to the key parameters – e.g. scope and protection provided in insolvency - governing its application. The substantive issues relating to each of these parameters are considered below. The Working Group's discussion of them will help the Commission to determine what specific changes are required to the main legal instruments. As far as possible the line taken on these issues should take account of any relevant evidence available (e.g. on the cost of due diligence given current legal uncertainties, the list(s) of eligible instruments lagging market developments etc), including on the potential ramifications of future problems.

### **Scope**

#### Material scope

24. The first issue concerns the need for more clarity on the definitions and terms used on close-out netting (resp. “set off” or “netting”), multilateral netting, cross-product netting and termination amounts; and on whether multilateral netting should be covered at all.

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<sup>10</sup> Complex legal databases have been developed for this purpose, e.g. the LeDIS-system and the Netalytics-system. Their sole existence demonstrates that despite having the Financial Collateral Directive one needs an algorithm for determining the effectiveness of close-out netting arrangements in other Member States.

***Do Member States experts believe that there is a need for further harmonisation of the definitions on close-out netting etc.?***

25. Second, the material scope depends on the approach taken to the type of contracts (e.g. swaps, forwards, repos, stock lending etc) that close-out netting provisions in EU law apply to. Key considerations here included the following:
- A choice should be made between having a generic list of contracts (which allows the parties to a close-out netting agreement to choose what the underlying assets are) which is exclusive (e.g. comprising repo, stock lending, swaps only) or one which is open-ended (e.g. a list including repo, stock lending, swaps with unspecified contract types also covered).
  - If market participants have the freedom to decide what contracts are subject to close-out netting, the relevant provisions of EU law would apply to all such contracts, thus ensuring legal certainty and reducing due diligence costs. In this case, the authorities' desire to prevent or limit netting in respect of some types of contracts could be achieved by other means, e.g. by setting onerous regulatory requirements in terms of capital, sanctions (e.g. de-authorisation or fines), due diligence etc on them.
  - But if a prescriptive, 'closed' list is preferred, the location of the boundary between contracts within and outside scope will need to be clearly laid out. Existing lists<sup>11</sup> may provide useful lessons here. It would be possible to create a specific (or 'autonomous') list or instead use an existing list established for another purpose.
  - Moreover, procedures for adapting such a list to market developments will have to be agreed.
  - In addition, clarity is required on whether a close-out agreement which covers contracts that are not on the prescribed list and others that are, is subject to the main close-out netting provisions in EU law.

***What are the views of Member States on the type of contracts that should be captured? Should there be an open or closed list (subject to revision)?***

Personal scope

26. Third, the scope of the provisions in terms of the type of counterparties they apply to must be delineated.

Extensive approach

- A wide or 'inclusive' scope reduces the risk of uncertainty about whether agreements are enforceable or not. Reflecting this, the risk of close-out netting being legally unenforceable could be considerably reduced, if not removed.

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<sup>11</sup> E.g. section C of Annex 1 of <http://www.mifidirective.com/mifid-directive.pdf>



- It also ensures that the benefits of close-out netting are widely available, rather than confined to a narrow subset of market participants. This could be beneficial for e.g. corporates dealing with insolvent banks. Indeed it could mean that all market participants potentially reap the benefits of close-out netting and thus remove the competitive distortions that result from a narrower scope.
- However, in order to obtain these benefits, the counterparties covered would need to be able, practically speaking, to meet e.g. the associated legal costs, margining obligations (where collateral is involved) etc, associated with standard close-out netting contracts.
- The question of whether they would all stand to benefit - rather than e.g. just those parties which typically hedge or balance their positions, as opposed to taking take only long positions – also arises. The answer is not clear-cut in that while some corporates may only use derivatives to hedge their underlying positions and therefore not run balanced derivatives books, they may be better placed than otherwise should their banking counterparties fail.

#### Narrow approach

- If only a restricted set of counterparties are covered by EU law, the question of who exactly and why, should be clarified and justified.
- If there was national discretion to determine the personal scope of EU close-out netting law, differences between Member States in key definitions could result in legal risk, or else substantial due diligence costs.
- If restrictions in personal scope are judged desirable, consideration should be given to alternative means of achieving this. These could include the imposition of onerous regulatory requirements - in terms of capital, sanctions (e.g. de-authorisation or fines), due diligence etc - on related transactions. The aim of such requirements might in part be to dissuade or prevent certain types of entities from transacting in instruments subject to close-out netting.

***What are the views of Member States experts on personal scope?***

***Do Member States experts believe that the scope should be extended to natural persons, including consumers? Or alternatively, that it should be left to national law to determine who may enter into a netting agreement?***

## LIMITATIONS ON ENFORCEABILITY

27. The protection of the Financial Collateral Arrangements Directive currently excludes the possibility of moratoria, stays and freezes. Thus, upon the default of one counterparty, close-out netting will take place as agreed by the parties without the insolvency administrator or any other official being able to freeze the situation for any given period of time. However, as stated above, restrictions on the exercise of rights under close-out netting agreements may be necessary under certain circumstances in order to maintain financial stability. In particular, national resolution authorities should have the power to impose a temporary

suspension of the right to exercise contractual termination clauses when a bank is subject to resolution measures. This is necessary to allow the authorities to select and transfer contracts to another financial institution, a bridge financial institution or other public entity (see P 42 of BCBS report<sup>12</sup>). One could imagine that any future legislation would cover the possibility of a stay or moratorium, a prohibition on cherry picking and provision on termination rights.

28. Finally, it should be noted that some Member States have already adopted or are going to adopt national laws on special resolution regimes which affect close-out netting arrangements<sup>13</sup>. In order to prevent disharmonised regimes across the EU, there might be a need to adopt some common rules on the treatment of foreign law assets caught by a transfer order.

### **“Stay or moratorium”**

29. The question is under what conditions a stay or moratorium should be allowed.
- The period of suspension should be as short as possible, and should not exceed [...] hours ;
  - The length of the stay should take account of relevant data/experience, including volatility data for the instruments that close-out netting agreements cover (e.g. derivatives) notably in the crisis ;
  - The application of a stay or a moratorium to a non-bank affiliate of a failing bank is potentially important ;
  - EU provisions on stays which are harmonised with those in third countries e.g. the US will facilitate the orderly resolution of cross-border groups. The same applies in respect of other limitations imposed in order to ensure financial stability.

***Do Member States experts agree that regulators or supervisors should in certain circumstances have the power to impose a temporary stay or moratorium?***

***If so, what are Member States experts' views on the length of such a stay?***

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<sup>12</sup> 'National resolution authorities should have the legal authority to temporarily delay immediate operation of contractual early termination clauses in order to complete a transfer of certain financial market contracts to another sound financial institution, a bridge financial institution or other public entity. Where a transfer is not available, authorities should ensure that contractual rights to terminate, net, and apply pledged collateral are preserved. Relevant laws should be amended, where necessary, to allow a short delay in the operation of such termination clauses in order to promote the continuity of market functions. Such legal authority should be implemented so as to avoid compromising the safe and orderly operations of regulated exchanges, CCPs and central market infrastructures. Authorities should also encourage industry groups, such as ISDA, to explore development of standardised contract provisions that support such transfers as a way to reduce the risk of contagion in a crisis.'

<sup>13</sup> In the UK the Banking Act 2009, The Banking Act 2009 (Restriction of Partial Property Transfers Order 2009) and The Banking Act 2009 (Third Party Compensation Arrangements for Partial Property Transfers Regulation 2009) – became effective on 21 February 2009. In Germany, the government draft of a Bank Restructuring Act (Restrukturierungsgesetz) of 25 August 2010 has been adopted in amended form by the first chamber of the German parliament (Bundestag) on 28 October 2010.

## **'Cherry picking'**

30. All contracts covered by a close-out netting agreement should be transferred or none at all – thus the authorities should be prohibited from 'cherry picking' contracts by e.g. transferring contracts which are 'in the money', but excluding the rest. In this context, special consideration must to be given to contracts involving non-EU counterparties and/or transactions subject to third country law.

*Do Member States experts agree with a prohibition of cherry picking?*

## **Termination rights**

31. At the end of the stay, termination rights can be exercised against the residual (and insolvent) institution if the transactions have not been transferred. Where the contracts have been transferred, termination rights may not be exercised solely as a result of the transfer, but are exercisable in full against any subsequent default by the transferee.
- The question of whether the non-defaulting party should pay any 'out of the money' sum due immediately (in order to potentially contribute to the orderly resolution of its counterparty), should be considered ;
  - The systemic implications of automatic termination clauses – as opposed to those which are triggered at the counterparties' discretion - could be significant. E.g. if a counterparty is unaware of a termination clause being triggered, it runs the risk of subsequent price movements causing material losses until it later seeks to replace its position ;
  - In principle, parties may react to any provision for stays, by relying increasingly on contractual provisions which allow for close-out upon specified pre-resolution events, especially in the early intervention phase of crisis management which immediately precedes resolution. Some argue that in practice this may not be a significant risk because the same counterparties which would have an incentive in putting such an early trigger into the netting contract would have an incentive not to put it in, because an early trigger could work against them. Experience to date may throw light on the extent of such provisions being used, reflecting which methods of monitoring this practice and where necessary limiting it, may require investigation.

*What are Member States experts' views on termination rights?*

## **CCPs**

32. Close-out netting is also particular important for CCPs and their ability to adjust market risk positions. Without netting agreements, CCPs would face substantial, uncontrollable risks because they could neither replace nor unwind the defaulted transactions with certainty.

***Do Member States experts consider that specific provisions are needed for CCPs?***

33. The question of whether those other systemic concerns mentioned earlier (notably regarding the potential inadequacy of overall credit monitoring and the possibility that close-out netting may in some circumstances give rise to destabilising contagion) which have not featured in the official response to the crisis (see e.g. BCBS report, footnote 6) should be addressed, should also be considered.
34. Such consideration could take account of the materiality of these concerns in relation to available evidence, the extent to which they may be addressed by regulatory measures undertaken for other purposes (e.g. new capital, liquidity and risk management requirements), possible additional remedies (e.g. differentiated treatment for centrally cleared as opposed to non-centrally cleared derivatives), the systemic implications of potential remedies given the vital role played by close-out netting, and the desirability of a global discussion/approach (given the mobility of the businesses covered and thus the risk of action in one jurisdiction leading to 'legal arbitrage', as well as competitiveness implications).

***What are Member States experts views on such concerns?***

**Read-across to other measures/policies**

35. While close out netting agreements are subject to specific provisions in the above instruments, it also features in certain other areas of EU law, in particular in bank regulation. It is proposed that the impact of possible legal changes to address current problems regarding close out netting be calibrated carefully; with a view to avoid any tightening especially in the short term given the possible repercussions for the wider economy.
36. On accounting, the International Accounting Standards Board (IASB) and the US Financial Accounting Standards Board are undertaking a joint project on netting as part of their convergence project which would ideally remove their current presentation differences. However, if differences in accounting treatment between US and International accounting rules remain they need not give rise to different prudential requirements, providing harmonised prudential figures are used instead as the basis of such requirements.

***What other key measures/issues need to be addressed in reviewing the legal basis for close-out netting, e.g. in respect of third countries and multi-branch entities?***

**NEXT STEPS**

**Broad options**

37. There are two main options in terms of the scope of the current initiative. First, it could focus narrowly on implementing the BCBS recommendations on crisis management especially providing for stays in resolution; and on easily tractable, legislative amendments which substantially increase legal certainty regarding the enforceability of close-out netting. Less material changes could be progressed in the periodic reviews of existing laws, with other concerns regarding the systemic costs

of close-out netting taken forward internationally, before being progressed in EU legislation.

38. Alternatively, there could be a comprehensive EU legal instrument on close-out netting which sought to tackle all existing concerns in a comprehensive manner. It might be difficult to complete such an initiative quickly, which could reduce the ability of national resolution authorities to deal with failing banks in the meantime.

<p><i>At this stage, do Member States experts consider that discussion should continue on both strands?</i></p>
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#### **Next steps**

39. The Commission Services intend to discuss close-out netting on the Member States Working Group at its further meetings, including additional important subjects such as the appropriate legal form of remedial Community intervention (e.g. a Directive or a Regulation).
40. The provisional plan will then be to arrange a three month market consultation, starting in February. Following the consultation and further meetings of the group, the Commission are considering to launch a legal proposal by end-July 2011.

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