

EU Close-Out Netting Initiative

Holger Hartenfels Quadrilateral Meeting San Francisco, 26 May 2011

Looking Back



- EFMLG Letter of 2 November 2004 on protection of close-out netting agreements in the European Community
- European Commission's evaluation report on the Financial Collateral Arrangements Directive (2002/47/EC) of 20 December 2006, page 10:

"There are also suggestions to improve the coherence of EU legislation on netting [...] However, further reflection is needed to see whether such a solution would be feasible."

• ISDA/EFMLG Joint Initiative of 14 April 2008 – Proposal for a European Netting Directive

Looking Back



 Basel Committee on Banking Supervision - Report and Recommendations of the Cross-border Bank Resolution Group, March 2010 - Recommendation 8:

> "Jurisdictions should promote the use of risk mitigation techniques [...] These risk mitigation techniques include enforceable netting agreement."

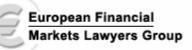
- November 2010 European Commission's consultation with financial industry, law firms and Member States
- Establishment of the Close-out Netting Member States Working Group – two Meetings on 17 December 2010 and 26 January 2011

Approach

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- Commission plans to adopt two instruments:
 - New framework for bank crisis management and resolution, addressing, e.g., the need for a stay of termination rights
 - New instrument on close-out netting agreements, ensuring the enforceability of netting especially in an insolvency
- Both instruments should be adopted simultaneously.
- Commission considers two approaches
 - "Top down" Emphasis is on the enforceability of close-out netting and the harmonisation of the current EU framework.
 - "Bottom up" Focus is on the bank resolution regime and the restriction of close-out netting; the enforceability of close-out netting beyond crisis management would be an "annex".

Netting Instrument – Content



- The proposed instrument on close-out netting is outlined in the Commission's discussion paper of 10 December 2010.
- Material scope definition of "close-out netting" and "insolvency proceeding", inclusion of restructuring
- Personal scope coverage of natural persons, need for additional exemptions
- Product Coverage exclusive list vs. open-ended list
- Conflict of law reference to the governing law (Article 25 of the Bank Winding-up Directive)

Suspension of Netting - Content

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- The proposed "bottom up approach" is outlined in the Commission's discussion paper of 17 January 2011
- Resolution authority should have the power to impose a temporary stay of close-out rights that arise solely by reason of action taken by the resolution authority (e.g., a transfer of assets to a "good bank")
- Suspension should not last longer than 48 hours
- Proposed safeguards: No partial transfer, transactions covered by a close-out netting agreement must be transferred all together, or not at all.
- Not protected by safeguards: e.g., retail rights and liabilities, subordinated debt (like UK Banking Act)

Outlook



- Initially Commission planned to publish proposals for both instruments by June 2011.
- However, the pending discussion on OTC Market Infrastructure (OTC derivatives, CCP clearing and trade repositories) caused considerable delay.
- New target for first proposals is now September 2011.
- UNIDROIT launched discussion on an instrument (Principles, Model Law or Convention) on close-out netting.
- First meeting of the UNIDROIT Study Group Meeting took place from 18 to 21 April 2011.
- The European Commission participated as observer and reaffirmed its intention to continue working on close-out netting...