

# **EU Close-Out Netting Initiative**

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**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

- **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



- **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...**