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on the enforceability of close-out netting
provisions
First session
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REPORT

(prepared by the UNIDROIT Secretariat)

Opening of the session

1. Mr J.A. Estrella Faria, Secretary-General of UNIDROIT, opened the first session of the Committee of Governmental Experts on the enforceability of close-out netting provisions (hereinafter referred to as the *Committee*), held at the Headquarters of the Food and Agriculture Organization of the United Nations in Rome, at 10.00 a.m. on 1 October 2012 and welcomed all participants.

Agenda Item No. 1 on the annotated draft agenda: Election of the Chairwoman

2. Mrs M. Vermaas, Head of Legal Services at Strate, South Africa, was elected Chairperson of the Committee at the proposal of the Brazilian delegation seconded by the delegation of Italy.

Agenda Item No. 2 on the annotated draft agenda: Adoption of the agenda and organisation of the session

3. Concerning the order of work, it was suggested that the Committee should start with the discussion of private international law issues, but the prevailing view was that the Draft Principles should be discussed in their numerical order in allow to clarify the substantive issues first before turning to the conflict of laws issues. The chairperson also suggested that observations specifically on the explanatory comments instead of the text of the Draft Principles should be dealt with at the end of the session. The Committee agree to this order of work.

4. The annotated draft Agenda (C.G.E./ Netting/1/W.P. 1) was adopted by the Committee as proposed.

5. It was also agreed that there would not be, at least at this stage, a need for setting up a drafting committee.

Agenda Item No. 3: Consideration of the Draft Principles regarding the enforceability of close-out netting provisions (UNIDROIT 2012 C.G.E./Netting/1/W.P. 2 and Addendum)**General**

6. The Chairperson noted that there appeared to be general agreement to the current structure of the Draft Principles, their nature as a soft law project and the approach so far taken.

Discussion of Draft Principle 1

7. The Secretariat described the basic reasoning underlying Draft Principle 1 and the scope of the term close-out netting as set out in this provision. The Chairperson proceeded to invite comments on the conceptual clarity of the idea of close-out netting as employed in the Draft Principles and its relationship to similar legal concepts.

8. It was clarified that the Draft Principles did not intend to cover statutory set-off in insolvency. This was generally agreed to, one of the reasons being given that it would be difficult to extend these Draft Principles, which were drafted on the basis of the application of a functional approach, to a legal concept such as statutory set-off in insolvency, which is essentially legally subject of varying treatment under domestic law.

9. Concerning multilateral close-out netting, it was pointed out that the Draft Principles were not intended to cover truly multilateral close-out netting, but only those situations in multilateral trading and settlement systems where a central counterparty substituted itself for the various participants, thus creating an element of mutuality in respect of the netted sums. It was generally agreed that this approach was correct. Cross-affiliate netting where no mutuality was established should not be covered. Since, however, many constellations that are often described in practice as multilateral netting – especially where central counterparties are used – could in fact be conceptualised as situations of bilateral netting, the explanatory comments should more specifically describe which situations should in fact be left out of the scope of application of these Draft Principles because there are true multilateral netting situations employing cross-guarantees and assignments to achieve the netting result.

10. There was some discussion concerning the question whether the Draft Principles should cover novation netting, which some participants thought would fall under the scope of the text of the Draft Principles, while the explanatory comments were said to point in the opposite direction. In this respect, it was agreed that novation (i.e. the creation of new obligations to replace the pre-existing ones), as one of the legal techniques through which close netting provisions might operate should be covered, whereas the type of transaction commonly described as settlement netting in market practice should not be covered, under which existing contracts were replaced by a new contractual relationship which includes new obligations which would then have to be performed by the parties (as opposed to the mere calculation of a net payment value as in the case of close-out netting).

11. Concerning the legal technique employed in the close-out netting process, it was agreed that the wording of Draft Principle 1 should be extended and reflect in more detail the various processes that could be used in order to achieve the close-out netting result. It was agreed that the phrase “the respective due and undue obligations of the parties are reduced to a single net obligation” should be replaced by the words “the respective due and undue obligations of the parties are reduced or replaced, whether by way of novation, termination or otherwise to a single net obligation”, partly resembling the wording used in Art. 2(1) lit. (n) of the European Financial Collateral Directive. It was agreed, however, that the term “transformation” should not be

mentioned as an additional legal technique here, since it appeared to lack a sufficiently precise and commonly accepted legal meaning, but that such possibility should be mentioned in the explanatory comments as an example of what could be understood as a technique other than those expressly mentioned in Draft Principle 1 used under the national legal system to achieve the result of a close-out netting operation.

12. Further, it was agreed that the Draft Principles should refer more prominently, even if only in the explanatory comments, to the term "acceleration" as one possible element of the close-out netting process, since this concept, which was used also in Art. 31(3) (j) of the Geneva Securities Convention was regarded as central in some Member States. In view of the functional approach followed by the Draft Principles, many Member States expressed their view that it was generally preferable, however, not to use the term "acceleration" as the only method by which close-out netting could operate, and this approach was agreed to.

13. Additionally, it was agreed that the word "remaining" in Draft Principle 1 should be deleted, since it could give rise to misunderstandings concerning, e.g., whether interest should be taken into consideration even though this was not part of the original face value of the underlying obligation.

14. Some participants requested that it should be considered whether the explanatory comments should cover in more detail that in the process of the close-out netting operation a monetary value was to be given to the original underlying obligations. On the other hand, it was agreed that in view of sentence 2 of Draft Principle 1 it did not appear to be necessary to give more prominence to the distinction between an automatic termination and a discretionary termination in sentence 1 of Draft Principle 1.

15. The Committee did not agree to a proposal to replace the words "due and undue obligations" in Draft Principle 1 with the terms "mature and unmatured obligations". The former terms were felt to be more in line with the general functional approach of the Draft Principles; moreover, it was thought that there could be difficulties in arguing that an unmatured obligation that was terminated before its maturity date actually ever becomes mature.

16. The suggestion was made that the present Draft Principle 1 could be split into two separate parts or provisions, the first being a provision on the scope of the Draft Principles (stating that they were to cover close-out netting provisions), the second containing the definition of the term "close-out netting provision". It was agreed that this issue should be left to the Secretariat for consideration for re-drafting for the next session of the Committee.

17. The Committee agreed that the discussion of comments on so-called "walkaway-clauses" and the problem of "wait and see" prerogatives within the context of Draft Principle 1 should be delayed until the discussion of Draft Principle 7.

18. There was support for the suggestion that – in the light of the deliberations of the Committee – Draft Principle 1 could be re-drafted along the following lines: "These Principles apply to close-out netting provisions relating to eligible obligations between eligible parties. A 'close-out netting provision' means a contractual provision under which, upon the occurrence of a predefined event in relation to one of the parties, the respective due and undue obligations of the parties are reduced or replaced, whether by way of novation, termination or otherwise, to a single net obligation representing the value of the combined obligations, which is then payable by one party to the other. Depending on the contractual agreement and applicable law, close-out netting occurs automatically by operation of the contractual agreement or may occur at the election of one of the parties."

Discussion of Draft Principles 2 and 3

19. The Secretariat introduced Draft Principles 2 and 3, highlighting the close connection between those two Draft Principles and emphasising that the delimitations of the scope of application of the Draft Principles, as set out in these two provisions, reflected underlying policy choices concerning the availability of close-out netting as a risk-managing technique. It was also pointed out that whatever the position should be concerning the extension of the scope of application of these Draft Principles to certain eligible parties and obligations, certain general overriding rules of the relevant legal system, such as its consumer protection rules, were not intended to be disapplied.

20. Draft Principles 2 and 3 were intensively discussed. Concerning the following issues, there was agreement in the Committee that if the present general approach of Draft Principle 2 was to be maintained (as to this discussion, see below), lit. (c) should be amended so as to refer to "any other person or legal entity designated as..." in order to allow the inclusion of entities that did not qualify as legal persons, e.g., collective investment vehicles.

21. Furthermore, it was agreed that, if the present general approach of Draft Principles 2 and 3 was to be maintained, rules on the extension of the scope of application of the Draft Principles to other eligible parties and obligations (Draft Principle 2(c) and Draft Principle 3(e)) should provide more guidance as to the content of the added elements.

22. There was also support for re-drafting Draft Principle 3(c) so as to extend it to all types of proprietary security, whether title transfer collateral or not, but limit it to such proprietary security that secured an eligible obligation.

23. As a matter of drafting, it was lastly agreed that the words "relating to" in Draft Principle 3(b) should be replaced by the more specific formula "for the sale or purchase of".

24. The Committee agreed that it needed to consider further a number of other issues, including the general approach to be followed in the determination of the scope of application of the Draft Principles. The following main strains of argument and suggested amendments of the Draft Principles were brought forward.

25. Several participants expressed the view that the objective of the protection against systemic risk should primarily govern the determination of the eligible parties and obligations. It was suggested that the Draft Principles should not apply to natural persons, since it was argued, amongst others, (i) that concerning them systemic risk was said to be of less relevance, (ii) that the principle of consumer protection would argue against the inclusion of consumers, and (iii) that the scope of the concept of close-out netting should not be too broad in order to respect the integrity and policy choices of the different national insolvency law systems. The rules on the personal scope of application of the European Financial Collateral Directive were cited as a possible model for the Draft Principles. It was also suggested to create a minimum and harmonised protection perimeter taking into account the main objective behind those general Principles which was to grant protection against systemic risk. It was suggested that such a perimeter should cover as a minimum all those financial transactions being conducted with at least one financial counterparty and allowing each State the possibility to decide to extend the scope to other operations and institutions. It was suggested by others to provide for the possibility for the enacting states to restrict the scope of application of the Draft Principles, which would allow each State to limit their application to cases where according to this State's view systemic risk was involved.

26. The countervailing, and strongly supported view favoured a broad personal scope of application of the Draft Principles. It was argued that insolvency law should not be directly dependent upon policy choices concerning the protection against systemic risk, which would rather be a regulatory issue. Whether or not there could be a systemic risk in relation to any party was said to be difficult to decide and to invite uncertainty. Participants in the energy market, for instance, were said to be in need of the protection available under close-out netting even though there was no systemic risk within the meaning given to that expression in connection with financial markets. Moreover, since the factor of systemic risk could sometimes even militate against the operation of close-out netting provisions (see Draft Principle 8), it was said that the presence of systemic risk should not by itself be the deciding factor concerning the determination of the personal scope of application of the Draft Principles.

27. The issue of the management of counterparty risk, however, which was said to be primarily addressed by close-out netting provisions, would apply to all parties alike, without inviting any distinction as to the presence of systemic risk. Especially high-net worth individuals would sometimes act on the market in a manner similar to legal persons so that there should at least be the possibility to extend the application of these Draft Principles to such persons. Also the European Financial Collateral Directive, it was argued, did not exclude an extension of the implementing legislation by the Member States. It was pointed out that even if the Draft Principles covered the use of close-out netting provisions by natural persons, there might still be regulatory or consumer protection law restrictions concerning their possibility to enter into certain transactions.

28. Several suggestions were made concerning a re-drafting of the personal scope of application of the Draft Principles, which the Committee agreed to keep under consideration in the course of its deliberations. Firstly, Draft Principle 2(c) could be re-drafted so as to allow the extension of the Draft Principles to certain types of natural persons only, mainly those acting in a professional capacity, trustees of investment trusts or high-net worth individuals. On a similar note, it was suggested that Draft Principle 2(c) could be re-phrased so as to directly refer to a criterion of systemic risk.

29. Secondly, it was suggested to draft the personal scope of application in Draft Principle 2 along the lines of Article 1(2) and (3) of the Financial Collateral Directive.¹

¹ "2. The collateral taker and the collateral provider must each belong to one of the following categories:
(a) a public authority (excluding publicly guaranteed undertakings unless they fall under points (b) to (e)) including:
(i) public sector bodies of Member States charged with or intervening in the management of public debt, and
(ii) public sector bodies of Member States authorised to hold accounts for customers;
(b) a central bank, the European Central Bank, the Bank for International Settlements, a multilateral development bank as referred to in Annex VI, Part 1, Section 4 of Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions (recast), the International Monetary Fund and the European Investment Bank;
(c) a financial institution subject to prudential supervision including:
(i) a credit institution as defined in Article 4(1) of Directive 2006/48/EC, including the institutions listed in Article 2 of that Directive;
(ii) an investment firm as defined in Article 4(1)(1) of Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments;
(iii) a financial institution as defined in Article 4(5) of Directive 2006/48/EC;
(iv) an insurance undertaking as defined in Article 1(a) of Council Directive 92/49/EEC of 18 June 1992 on the coordination of laws, regulations and administrative provisions relating to direct insurance other than life insurance (third non-life insurance Directive) and an assurance undertaking as defined in Article 1(1)(a) of Directive 2002/83/EC of the European Parliament and of the Council of 5 November 2002 concerning life assurance;
(v) an undertaking for collective investment in transferable securities (UCITS) as defined in Article 1(2) of Council Directive 85/611/EEC of 20 December 1985 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS);
(vi) a management company as defined in Article 1a(2) of Directive 85/611/EEC;

30. Thirdly, it was suggested that the elements of the eligible parties and the eligible obligations could be combined. In cases where both parties were financial institutions (in the sense of an entity falling under Art. 1(2)(a) to (d) of the Financial Collateral Directive), all mutual obligations between those parties could be eligible. In cases where only one party was a financial institution, but not the other (who should also not be a natural person), only the following mutual obligations between these parties could be eligible: all standard derivative transactions (going beyond Draft Principle 3(a) and covering also derivatives relating to currencies or commodities), and additionally all other eligible obligations under Draft Principle 3(b) and (d) nos. 1 – 3, as well as all obligations under proprietary security, whether title transfer collateral arrangements or not, covering other eligible obligations.

31. No consensus was reached on those issues and the Committee agreed to come back to the discussion at a later stage.

Draft Principle 4

32. It was clarified that Draft Principle 4 was not intended to affect formal requirements for the creation, validity and effectiveness of secured transactions. It had been agreed by the Study Group that proprietary aspects of secured transactions were generally outside the ambit of those Draft Principles. In the same vein, it was clarified that even where one agreement purported both to create a security interest and to provide for close-out netting, the fact that the latter provision would be valid under present Draft Principle 4 without the need for additional formal requirements would not make the security interest effective if the relevant requirements for perfection of the security interest under secured transactions law were not complied with. Moreover, if the security agreement was not effective, there could generally also not be close-out netting concerning the obligation to retransfer the collateral under the (invalid) security agreement. As an issue that could be alluded to in the comments it was mentioned that the legal position might be different where the parties subsequently validly agreed on the transformation of the obligation to re-transfer collateral into a monetary obligation.

33. In the ensuing debate, there was extensive discussion as to whether it was correct for Draft Principle 4 to provide that the failure to comply with requirements such as registration requirements should not lead to the ineffectiveness of the close-out netting provision. Some participants argued that in their view the sanction of ineffectiveness was required as a protection against the dangers of fraud and back-dating of transactions. It was argued that it was necessary to affirm that reporting requirements under regulatory law should be strictly enforced, since they served to monitor and protect against risks building up in the market. Such a need was said to exist especially concerning transactions involving parties that were not itself subject to regulation and supervision as financial market participants.

34. In response, there was strong support for retaining Draft Principle 4 in its present form, since several participants felt that ineffectiveness as a response to a failure to comply with formal requirements would be inappropriate. While there might be cases of actual fraud, sanctioning a

(d) a central counterparty, settlement agent or clearing house, as defined respectively in Article 2(c), (d) and (e) of Directive 98/26/EC, including similar institutions regulated under national law acting in the futures, options and derivatives markets to the extent not covered by that Directive, and a person, other than a natural person, who acts in a trust or representative capacity on behalf of any one or more persons that includes any bondholders or holders of other forms of securitised debt or any institution as defined in points (a) to (d);

(e) a person other than a natural person, including unincorporated firms and partnerships, provided that the other party is an institution as defined in points (a) to (d).

3. Member States may exclude from the scope of this Directive financial collateral arrangements where one of the parties is a person mentioned in paragraph 2(e). If they make use of this option Member States shall inform the Commission which shall inform the other Member States thereof."

failure to comply with reporting and similar requirements with the ineffectiveness of the close-out netting provision risked punishing innocent parties as well. It was pointed out that nothing in the Draft Principles precluded adequate sanctioning of actual fraud; moreover, regulatory measures could provide for a variety of other sanctions for the failure to comply with formal requirements.

35. There was no decision as to the general approach to be taken concerning Draft Principle 4 and it was agreed to keep those matters under consideration in the course of the further deliberations of the Committee, since they were felt to be closely linked to the approach to be taken concerning the scope of the eligible parties.

Draft Principle 5

36. No comments were made in connection with Draft Principle 5, which was taken as evidence that the Committee agreed to that provision as presently drafted.

Draft Principle 6

37. In relation to Draft Principle 6, there was a discussion as to whether the Draft Principle should be restricted so as allow the enacting States to provide for the ineffectiveness of the transaction concerned as a consequence of the failure to comply with regulatory reporting and registration requirements.

38. Some participants argued that such requirements protected against dangers of back-dating and fraud and therefore the sanction of ineffectiveness would fulfill an indispensable role. As in relation to Draft Principle 4, it was argued that this applied especially to entities that were not otherwise subject to regulation and supervision as financial market participants.

39. Other participants, however, held also in relation to Draft Principle 6 the view that ineffectiveness was an inappropriate response to the failure to comply with reporting requirements and that the regulatory policies at stake could better and more precisely be dealt with through other types of regulatory penalties or through restrictions concerning some parties' possibility to enter into the transactions concerned.

40. As a compromise, it was suggested that Draft Principle 6 could be amended so as to provide that the consequences dealt with in this Draft Principle should not follow from a "mere failure" or "solely on the ground of a failure" in order to highlight that those Draft Principles as a matter of course allowed such consequences where there was for example actual fraudulent behaviour, in relation to which the fact of the compliance or non-compliance with reporting requirements could possibly even be regarded as an evidentiary factor. The details were to be left to the Secretariat. This suggestion was agreed to as a solution for the discussion concerning Draft Principle 6.

Discussion of the explanations and commentary to Draft Principles 1, 4 to 6

41. The Chairperson then invited participants to comment on the explanations and commentary to Draft Principle 1 and 4 – 6. In the subsequent discussion, the following points were raised in relation to these topics.

42. Additional clarification was sought for the question as to whether those Draft Principles covered multilateral netting. While the general policy, as discussed on the first day of the session of the Committee, was accepted, it was suggested that the relevant portions of the commentary could clarify, possibly even in the key considerations to Draft Principles, that those Draft Principles were to apply to normal bilateral netting and to situations involving central counterparties and

clearing houses, but not to apply to true multilateral situations, since this did not seem to be excluded on the basis of the text of Draft Principle 1.

43. Furthermore, it was suggested that the scope of the Draft Principles as regards netting on a non-contractual basis could be clarified, especially with regard to situations of settlement systems operating on the basis of government regulation. While some answer to this issue could be found in para. 15, the point was raised that such situations could also give rise to problems under the present wording of the chapeau of Draft Principle 3, since there could be doubts as to whether in such situations the eligible obligations were actually arising under the rules of the settlement system, rather than under a contract.

44. In relation to the restriction of the Draft Principles to contractual netting, there was also a suggestion to reconsider whether the issue of close-out netting that took effect partly on a contractual basis, partly on a statutory basis, was given sufficient attention, specifically in relation to situations where under the applicable legal system there was a mandatory termination in order to prohibit the practice commonly referred to as wait-and-see. On the basis of paras. 13 and 22, such situations would be covered by the Draft Principles. Similar problems were mentioned in relation to the treatment of valuation methods, which are dealt with in para. 29.

45. It was also pointed out that there should be a review of the terminology of the Draft Principles, which currently employed different language in Draft Principles 1 to 3, when referring to "applicable law" (Draft Principle 1), "the law of the relevant state" (Draft Principle 2) and "the relevant law" (Draft Principle 3(e)).

46. It was agreed that those issues, as well as the written comments by Member States and Organizations which referred to issues of drafting of the commentary and explanations, in relation to which no objections were raised, should be taken into account by the Secretariat in the course of its re-drafting and preparation of the text of the Draft Principles for the next session of the Committee.

47. Two other issues raised in that discussion were deferred to the discussion of later Draft Principles. Firstly, clarification was sought as to whether national rules on standard terms and conditions in some jurisdictions could prevail over the enforceability of close-out netting provisions according to their terms, an issue that was felt to be more closely related to Draft Principle 7. Secondly, the issue of the relationship between (valid) close-out netting provisions and security agreements that failed to meet the requirements for effectiveness under the relevant secured transactions law was taken up again. It was asked whether – even if it was accepted that the proprietary aspects of secured transactions law were intended to remain unaffected by those Draft Principles – the effectiveness of the close-out netting provision would have the effect that the (obligatory) agreement for the posting of security (security agreement) would be effective as well. This was an issue said to be more closely related to the discussion of the eligible obligations under Draft Principle 3.

Draft Principles 2 and 3

48. The discussion of Draft Principles 2 and 3 was reopened on the basis of the draft preliminary proposal for Draft Principles 2 and 3 submitted to the Committee as document C.G.E./Netting/1/INF. 4 (see Annex III to this Report).

49. Some members of the delegations supporting this proposal argued that the more restrictive approach concerning the scope of application of the Draft Principles followed by that proposal would focus on systemic risk as the main concern of the Draft Principles, while at the same time allowing the States, if they so wished, to extend the scope of application of legislation giving effect

to close-out netting to other parties or obligations as well. The approach of the proposal was described as a minimum harmonisation approach, taking into account existing differences between various legal systems, which at the present stage were said not to allow any broader rules on close-out netting, while not preventing those States that were in favour of a broad scope of application for close-out netting from applying these rules already now also to other parties or obligations.

50. Other delegates noted that the proposal reflected a rather radical departure from the approach originally followed by the Study Group and also the Draft Principles so far, so that they reserved their judgment and declared themselves unable to comment upon this proposal at the present stage.

51. A number of other delegates expressed strong objections to the proposal. It was regretted that under the default position of the proposal transactions concluded between two corporate entities would not be eligible for netting unless at least one of those entities qualified as an eligible party under Draft Principle 2 (a) to (f) of the proposal. Such an approach would deprive for example energy traders from the protection which they were said to need for their netting transactions and which in the view of some participants would also involve systemically relevant risks, even if not strictly speaking referring to a financial market systemic risk. It was argued that, from the perspective of the market participants, close-out netting was primarily a method for the management of counterparty risk. That made it difficult to distinguish between financial entities (i.e. the eligible parties under Draft Principle 2 (a) to (f) of the proposal) and other corporate entities concerning their need for protection.

52. Even concerning financial entities in the afore-mentioned sense, it was argued that the availability of close-out netting under the proposed text would be unduly restricted by excluding spot contracts from the list of eligible obligations under Draft Principle 3 (a) to (e) of the proposal, even though it was noted that some extension would be possible under the second paragraph of Draft Principle 3 of the proposal.

53. In view of the new proposal, some members of the Committee expressed their support for the original drafting of Draft Principle 2, and even a suggestion was made to extend the original Draft Principle to (a) any person, whether natural or legal; and (b) any other unincorporated entity designated as an eligible party by the relevant law.

54. Other members of the Committee argued that while the general approach of the new proposal for Draft Principle 2 could be agreeable, there seemed to be no sufficient justification for the restriction of the eligible obligations as compared to the original Draft Principle 3. Another suggestion was that the general approach of the proposal could be retained, if such obligations concluded between two non-financial entities were added to the scope of application which were either concluded in an organised market or processed through a clearing and settlement system.

55. Concerns were also raised in relation to the wording of the proposed Draft Principle 2 (i), which was said not sufficiently to take into account the previous considerations of the Committee concerning the possibility to extend the scope of the Draft Principles to entities that did not qualify as persons. It was suggested that Draft Principle 2 (i) would have to be rephrased so as to refer to other entities as well.

56. It was also pointed out that the proposal gave rise to several doubts, for example as to whether the reference in the chapeau of the first sentence of Draft Principle 3 only to "at least one of the parties" as an eligible party meant that the other party to the transaction would not have to be an eligible party at all. The third paragraph of the proposed Draft Principle 3 was said to be unclear as to whether a State could also choose to designate only some of the contracts or parties

referred to in this provision as eligible. Moreover, members of the Committee wondered whether the fact that the third paragraph of proposed Draft Principle 3 did not refer to the second paragraph of Draft Principle 3 should be understood to suggest that no State could designate the obligations covered by the second paragraph as eligible obligations in relation to eligible parties covered by Draft Principle 2 (g) to (i). Some members of the delegations supporting this proposal indicated that such a restriction had not been intended.

57. As a possible solution to take into account some of the earlier deliberations of the Committee it was suggested that, if this proposal was to be adopted, the proposed Draft Principle 2 (g) should be rephrased as follows: "a person other than a consumer." This suggestion did not meet any objections and was generally supported.

58. Several other suggestions concerning possible amendments of the proposal were also brought forward: It was recommended that the proposal should be drafted in such terms as to allow the development of new financial products and also obligations arising under master-master agreements. Another proposal was that in the relationship between entities covered by the proposed Draft Principle 2 (b) on the one hand and entities covered by Draft Principle 2 (c), all obligations should be regarded as being eligible for close-out netting. Finally, it was argued that also in this proposal, rules allowing an extension of the scope of application should contain some guidance as to which criteria could be relevant for the exercise of this discretion.

59. The Chairperson summarized the interventions of the members of the Committee as follows: While some members of the Committee supported the new proposal, several reserved their views, while many expressed general concerns requested further drafting clarification or raised a number of specific issues which required further consideration by the Committee.

Draft Principle 7

60. The Secretariat gave an introduction to Draft Principle 7, referring to the policy decisions by the Study Group and highlighting the central nature of the Draft Principle for the project. It was pointed out that the protection of the enforceability of close-out netting provisions in insolvency under Draft Principle 7(c) was the core of the protection under the Draft Principles, but that such protection was neither unlimited nor intended to render effective those transactions that were ineffective for any other reasons.

61. Several Members of the Committee argued that the first and second sentences of Draft Principle 7 were too widely drafted, since they did not give sufficient consideration to the restrictions to the enforceability of close-out netting provisions more expressly envisaged in the explanations and commentary to the Draft Principles. It was suggested that the phrase "without limiting the generality of the foregoing" was liable to give rise to misunderstandings concerning the possibility of exceptions to the general enforceability of close-out netting provisions in insolvency and should therefore be dropped.

62. The same was said to apply to the reference in the first sentence of Draft Principle to the effect that the close-out netting provision should be enforceable "before and after" the commencement of insolvency proceedings. It was argued that the restrictions concerning the effectiveness of close-out netting provisions following from basic civil and commercial law principles, such as the general rules on fraud or contract validity, which could provide for ineffectiveness even before the commencement of insolvency proceedings, would remain unaffected, as mentioned in para. 89 of document C.G.E./Netting/1/WP 2, and that this was not adequately reflected in the present version of the Draft Principles and commentary.

63. Concerning the various basic civil and commercial law principles under the relevant law, there was also a discussion specifically relating to requirements of commercial reasonableness and good faith. It was argued that there should be an express reference in the text of the Draft Principle to those concepts so that the enforceability of the close-out netting provisions would be upheld only if the standards of good faith and commercial reasonableness were satisfied. The Committee generally supported the view that those concepts were difficult to translate in a uniform rule and should not, therefore, be introduced as general requirements also for jurisdictions which so far did generally employ these concepts. Jurisdictions that had such general requirements as conditions for the enforceability of the close-out netting provisions or for its mechanism of valuation remained anyway free to apply them. It was agreed that the issue of good faith and commercial reasonableness should be left for the Secretariat to deal with in the commentary in the course of the preparation of the Draft Principles for the next session of the Committee.

64. It was suggested that Draft Principle 7(b) should be clarified with regard to the effects of situations in which some of the obligations covered by a master agreement constituted eligible obligations, while others did not. One drafting suggestion was to add words such as "but only for these obligations that are enforceable and eligible" at the end of the provision, another suggestion was to start the provision with words such as "a close-out netting provision remains enforceable in relation to eligible and enforceable obligations covered, even if...". The intention, it was said, was to clarify that the close-out netting provision remained valid, while the obligations that were ineligible or unenforceable would not be included into the netting operation. It was agreed that the Secretariat should be requested to redraft Draft Principle 7(b) accordingly.

65. Furthermore, the Secretariat was requested to consider whether the term "repudiate" in Draft Principle 7(c)(i) should be replaced by "reject" in order to use similar terminology as in the UNCITRAL Legislative Guide on Insolvency.

66. In relation to Draft Principle 7(c)(i), the Secretariat was requested to clarify, possibly in the commentary, whether and to what extent the insolvency administrator could be entitled to reject the performance of a contract if the counterparty of the insolvent debtor had chosen not to exercise its termination rights under the close-out netting provision.

67. There was not sufficient support for the suggestion that the rule in Draft Principle 7(c)(ii) should be made subject to an exception concerning the opening of reorganisation proceedings in relation to non-financial corporates, even in the absence of default of payment.

68. Concerning the issues addressed in Draft Principle 7(c)(iii) and Draft Principle 7(c)(iv), it was generally accepted that neither the conclusion of the close-out netting provision as such, nor the timing of the conclusion of this agreement, should be regarded as sufficient basis for an action for the avoidance of a preference. The same was said of the actual exercise of the discretion to terminate the relationship under a close-out netting provision. In this respect, the conclusion of the close-out netting agreement was said to be different from, for instance, a payment made under the same circumstances, which might be subject to avoidance under domestic insolvency law. However, it was argued that the presence of additional elements might justify such an insolvency avoidance action in both Draft Principle 7(c)(iii) and Draft Principle 7(c)(iv). Those additional elements were said to be difficult to define, and it was accepted that no complete harmonisation of the various national insolvency law provisions in that respect would be achievable. Some Members of the Committee argued that they would not regard mere subjective factors such as the knowledge of the counterparty's situation of financial distress as being sufficient additional factors, while others suggested that the controlling factor should be the intention to disadvantage other creditors. There was some doubt as to whether it might be feasible, within the limited scope of the Draft Principles, to properly reflect all those nuances, and it was suggested that it might be better to stress that the law of the enacting States remained free to determine the consequences of

actual fraud. The Secretariat was requested to consider the appropriate detail of clarification that might be needed in a re-draft of the current text of the relevant portions of the commentary.

69. It was generally accepted that Draft Principle 7 should not constitute an obstacle to the insolvency effectiveness of close-out netting also in situations where master-master agreements were used. It was agreed that such agreements differed only in form, but not in substance from master agreements drafted in wide terms. However, it was pointed out that Draft Principle 7 would protect such master-master agreements only to the extent that all covered obligations were eligible for netting. It was suggested, however, that Draft Principle 1 might need some clarification concerning the extension of the scope of the Draft Principles to master-master agreements, possibly in the explanations and commentary. The Committee supported that view.

70. In relation to walk-away clauses there was general support for the suggestion that it should be left for each national legislator whether to uphold such clauses or not.

71. Several Members of the Committee expressed the concern that some sub-provisions of Draft Principle 7 seemed to suggest that obligations that would otherwise be unenforceable might become enforceable merely by reason of being covered by a close-out netting provision. While it was accepted that such an understanding of Draft Principle 7(c)(i) was not intended, it was confirmed that this was indeed the stated objective of Draft Principle 7(c)(iv). It was generally accepted that such an effect could only take place exceptionally and should not be extended beyond Draft Principle 7(c)(iv) to the situations addressed in Draft Principle 7(c)(iii), since it could not be ruled out that the conclusion of an (underlying) contract might in fact confer an unfair advantage on one creditor. Some participants in the Committee, however, reserved their position as to whether the present draft of Draft Principle 7(c)(iv) was appropriate to cover the underlying obligations as well, feeling that the issue needed further consideration.

72. The view was expressed that, despite the stated intention of the Draft Principles not to interfere with the ranking of claims under domestic insolvency law, such interference might nevertheless result from the fact that subordinate claims were bundled with other claims under a close-out netting provision that benefitted from the safe-harbour rule in Draft Principles 7. Several possible solutions were suggested to deal with that problem. One alternative could be to disregard the subordination, effectively giving the creditor of the subordinated claims a preferred rank. Another alternative could be to exclude subordinated claims from the netting operation. Yet another option could be to provide that each master agreement should not relate to both subordinated and non-subordinated claims. In this respect, it was also pointed out that a mere contractual subordination would not have to be considered as constituting an obstacle to the operation of a close-out netting provision according to its terms, while for cases of statutory subordination it was suggested that each State concerned should individually decide how such subordinated claims should be treated in relation to close-out netting provisions. The Committee agreed that those issues required further consideration at a later stage.

Draft Principle 8

73. In the introduction to Draft Principle 8 the Secretariat pointed out that that provision sought to reflect the approach taken by the Financial Stability Board in its Key Attributes of Effective Resolution Regimes for Financial Institutions (October 2011).

74. A number of participants argued that the provision should have a wider scope of application than under the current draft. Where there was a transfer of assets in the course of bank resolution measures, the operation of the close-out netting provision should be not only temporarily, but permanently stayed, i.e. it should be permanently ruled out that the transfer could be regarded as

a trigger for the close-out netting provision. Moreover, the Secretariat was requested to clarify whether this provision applied to resolution procedures before courts and administrative authorities alike and also both to measures specifically ordered by the resolution authorities and to measures taking effect by operation of law.

75. While some participants felt that the provision should include a specific list of resolution measures and of their respective civil law consequences, there was widespread support for a redrafting of the provision by moving the second paragraph into the commentary and redrafting the remaining part of the provision in more general terms. All possible measures of resolution authorities, which should include adequate safeguards, should be covered by such a broad provision. In the commentary there should be a reference to the Key Attributes of the Financial Stability Board.

76. Concerning restrictions to the rule in Draft Principle 8, i.e. situations in which measures taken by the resolution authorities should in fact be able to trigger rights under close-out netting provisions, some participants argued that a more specific description would be helpful, e.g. concerning a suspension of payments ordered by the resolution authority or in relation to cherry-picking by the resolution authority, i.e. the transfer of only some assets covered by the same master agreement to another entity. Others argued that also such counter-exceptions should better be referred to only in general terms.

77. It was agreed that the Secretariat should work along these lines and consider a redrafting of this provision for the next session of the Committee.

78. One participant expressed the view that the fact that the exception in Draft Principle 8 related only to financial institutions could be against the principle of non-discrimination.

Draft Principles 2 and 3

79. The discussion of the draft preliminary proposal for Draft Principles 2 and 3 (C.G.E./Netting/1/INF. 4, see Annex III to this Report) was then reopened.

80. While some members of the delegations supporting the proposal argued that this draft could be seen as an imperfect, but nevertheless workable compromise, several other participants of the Committee once more expressed concerns in relation to the draft proposal and voiced their support for a more liberal approach concerning the scope of the eligible parties and eligible obligations. It was argued that it was an issue that was too important and could not be left open for the individual States to decide whether large corporate entities could be eligible parties.

81. The original Draft Principle 2 was said to be preferable to the new draft proposal, this also in terms of drafting. It was conceded that a differentiated definition of the eligible parties was necessary if there was to be a differentiated approach as to the obligations eligible for netting in relation to different parties. Nevertheless, it was argued that generally a short rule as in the original Draft Principle 2 was more in line with the general approach to be taken by soft law principles as compared to the detailed list contained in the proposed alternative. The suggestion was repeated that the scope of the eligible parties could be drafted even in broader terms than under the original Draft Principle 2, e.g. by extending it to any person or entity except for a consumer.

82. A number of participants argued that if the general approach of the new draft for Draft Principle 2 was to be followed, there should at least be a redrafting of the proposed Draft Principle 2 (g), which should read "a person other than a consumer". As an alternative, it was suggested "a person other than a non-merchant natural person".

83. Specifically concerning the proposed Draft Principle 3, it was suggested that the second paragraph should rather be an opt-out provision, thereby providing that as default position the obligations covered by this provision would be eligible obligations. Another suggestion was to include non-financial corporates (i.e. corporate parties not covered by the proposed Draft Principle 2(a) to (f)) in the first paragraph of the proposed Draft Principle 3.

84. Criticism concerning the restriction of the scope of eligible obligations in the first paragraph of the proposed Draft Principle 3 was also expressed by other participants who argued that this restriction, which was explained by some of the members of the delegations supporting this proposal as being intended to distinguish between financial instruments and other obligations, lacked sufficient justification. It was argued that gold fixing was also a financial transaction and that the same applied to foreign exchange transactions.

85. Specifically concerning the proposed Draft Principle 3(c), there was no unanimity as to whether the text in brackets (which was explained by some members of the delegations supporting this proposal as covering also obligations under the second paragraph of the proposed Draft Principle 3, if those should be so designated by the relevant State) should be deleted. While some members of the Committee argued for its retention, others favoured its deletion since otherwise collateral securing cash would probably not be covered by the proposed Draft Principle 3.

86. It was explained that the proposed Draft Principle 3(c) was restricted to title transfer collateral arrangements, while limited proprietary security was intended to be covered by the last part of the second paragraph of the proposed Draft Principle 3. In relation to that last part of the second paragraph of the proposed Draft Principle 3 the point was raised that it should be clarified why this draft provision was not extended to delivery obligations under such a security interest or collateral arrangement.

87. Finally, there was a suggestion that if the general approach of the proposed Draft Principle 3 was to be retained, its first paragraph should be extended to master-master agreements and to transactions concerning emission allowances as well as contracts for the clearing of contracts covered by letters a) to d) of the proposed Draft Principle 3.

88. After consideration of the various views expressed, it was noted that there seemed to be interest for further exploring the potential offered by the new approach followed by the draft proposal for Draft Principles 2 and 3 (C.G.E./Netting/1/INF. 4, see Annex III to this Report) as a basis for a possible solution for bridging the gap between those within the Committee who favoured a broad understanding of the eligibility of parties and obligations, and those who advocated limiting the eligibility of certain obligations to the nature of the parties concerned. However, in view of the various reservations that had been expressed to such a fundamental switch of the approach underlying the current draft, the implications of which several participants did not have sufficient opportunity to ponder upon, it was felt that there was not yet a sufficiently broad consensus for discarding the current approach followed in the Draft Principles, as contained in the document C.G.E./Netting/1/WP 2 and replacing it with the new proposals as the sole basis for future discussions. Nevertheless, in the light of the positive reactions to the proposed new Draft Principles 2 and 3, the Committee agreed that the text of the draft proposal should be included as an Annex to the Report for the current session of the Committee and encouraged the participants, to continue their consultations between the current and the next session of the Committee on how the new proposal could be further improved, taking into account the reservations expressed so far,

with a view to making of it a possible basis for an even wider support. Delegations were encouraged to explore the possibility of reconciling the alternative proposal for Draft Principle 2 and 3 with a more simplified approach as followed by the Draft Principles set out in document C.G.E./Netting/1/WP 2, possibly on the basis of an opt-out solution, which could appear easier to craft.

Draft Principle 9

89. The Secretariat introduced Draft Principle 9, highlighting that Draft Principle 9 was intended to leave the determination of the proper law for close-out netting provisions to the private international law rules of each enacting State. Instead, the primary remit of Draft Principle 9 was explained to be the delimitation of the scope of application of the proper law of the close-out netting provision in the case of the commencement of insolvency proceedings. Paragraphs (1) and (2) of Draft Principle 9 were said to be intended to provide that even in the case of the commencement of insolvency proceedings, the issues covered by those provisions would not be subject to the law of the State where insolvency proceedings were commenced, but would continue to be governed by the proper law of the close-out netting provision. It was explained that this solution was inspired by the Study Group's understanding of Art. 25 of the European Banks Winding-up Directive.

General issues in relation to Draft Principle 9

90. In the discussion of the Draft Principle, several issues of a general nature were raised. Firstly, the representative of the Hague Conference on Private International Law pointed out that the Hague Conference did not see any obstacle concerning the respective competencies of the two Organisations which would prevent UNIDROIT from including private international law issues in an UNIDROIT instrument.

91. Secondly, several participants expressed the view that it would be preferable if the Draft Principles, to the extent that they were to address issues of private international law, would contain a provision that actually determined the applicable law for close-out netting provisions. In that respect, a preference was expressed for an acknowledgment of the principle of party autonomy in private international law, in addition to which there should be a default rule determining the applicable law in the absence of a (valid) choice of law by the parties. However, it was generally accepted that, for the time being, there was no sufficient international consensus concerning which law should govern those matters, so that the current approach of the Draft Principles was to be maintained, according to which those matters were left to be determined under each State's own private international law rules.

92. Thirdly, there was broad support for the suggestion that the present Draft should be clarified concerning the reference, in the relevant portion of the commentary, to internationally mandatory rules under the private international law of the forum state and their relationship to the Draft Principles. With a view to promoting legal predictability and certainty, one participant pointed out that the interplay between the law governing the netting provision and the law governing insolvency proceedings, as laid down in Draft Principle 9, should be a reflection of the Committee's view on what the internationally mandatory rules were meant to reflect and this should not be set aside on the basis of domestic interpretation of internationally mandatory rules.

93. Fourthly, there was wide support for the recommendation that the general principle that insolvency proceedings should recognise existing rights and obligations of the insolvent debtor under their own law regardless of the law of the forum of the insolvency proceedings should be given more prominence in Draft Principle 9.

Paragraph (1) of Draft Principle 9

94. Concerning paragraph (1) of Draft Principle 9, there was broad support for the suggestion that the provision should be redrafted by the Secretariat, taking into account the drafting proposal submitted by the Government of the United States of America that was contained in document CGE/Netting/1/WP 03. That drafting proposal, which included, *inter alia*, a rearrangement of the present content of paragraphs (1) and (2) of Draft Principle 9, was said to set out the stated policies of these provisions more clearly than the present draft.

95. There was no sufficient support for the suggestion of a more radical simplification of paragraph (1) of Draft Principle 9, according to which it would merely have been said that the determination of the law applicable to the close-out netting provision should be subject to the private international law of the forum, unless insolvency proceedings were commenced.

96. Neither did the suggestion that the reference in paragraph (1) of Draft Principle 9 should be limited to the substantive private law of the governing law regime only (to the exclusion of its insolvency law) find further support.

97. The Secretariat was asked to consider whether the reference to "effectiveness" in paragraph (1) of Draft Principle, to the extent that such reference were retained after the suggested re-drafting of this provision, should be clarified and possibly aligned with the language used in other provisions of the Draft Principles.

Paragraph (2) of Draft Principle 9

98. A number of participants supported the approach followed by this provision. They argued that the provision would protect the parties' expectations concerning the applicable law and the principle was regarded as forming part of the European *acquis communautaire*, which provided that, even after insolvency proceedings had been commenced, the close-out netting provision should continue to be governed by its own law, to the exclusion of the law of the forum of the insolvency proceedings.

99. Other delegates, however, expressed concerns as to whether, under the approach taken in the Draft Principle, policy decisions of an enacting State would have to be disregarded in the event of insolvency proceedings conducted before the courts of that enacting State if the parties had chosen a different law for their close-out netting provision, and that other law provided for a wider range of eligible parties or obligations than the law of the forum. It was argued that, in insolvency proceedings, there should not be such a possibility for the parties to choose an applicable law that could override the policy decisions of the forum state. As an alternative, it was suggested that the parties' freedom of choice could be restricted by providing that the determination of the eligible parties and obligations should be governed by the law of the debtor's centre of main interest (COMI).

100. While some delegates who had expressed such concerns in relation to the policy underlying the present paragraph (2) of Draft Principle 9 had advocated that the provision should be deleted here, with the reference to the eligible parties and obligations being moved to paragraph (4), others pointed out that the issues covered by paragraph (2) also mattered outside insolvency proceedings. There was no objection against referring the determination of the eligible parties and obligations outside insolvency proceedings to the proper law of the close-out netting provision, and there was general support for the suggestion that the Secretariat should undertake to clarify the rule spelt out in the present paragraph (2) in that respect.

Paragraph (3) of Draft Principle 9

101. Concerning paragraph (3) of Draft Principle 9, there was agreement that the term "previous" and the phrase "and to the extent that choice-of-law clauses are admitted by the relevant rules of private international law" should be deleted, but that the latter phrase might need to be retained if the new version of paragraph (1) incorporated the drafting proposal submitted by the Government of the United States of America that was contained in document CGE/Netting/1/WP 03.

102. A concern was raised as to whether the issue addressed in paragraph (3) of Draft Principle 9 was not rather an issue of general contract law, but that argument did not find sufficient support.

103. Moreover, it was pointed out that paragraph (3) of Draft Principle 9 would have to be adapted in the case of a redrafting of paragraphs (1) and (2) of this Draft Principle in order to ensure that the cross-reference therein referred to the correct provision.

Paragraph (4) of Draft Principle 9

104. As a general issue in relation to the references to the law governing the insolvency proceedings in paragraph (4) of Draft Principle 9, it was highlighted that Art. 25 of the European Banks Winding-up Directive was understood by some participants as excluding any such references within its scope of application. One participant argued that this problem could be solved by extending the reference to the private international law rules of the forum state, which would then include the conflict of laws provisions enacted in the implementation of this Directive.

105. Specifically in relation to paragraph (4)(a) of Draft Principle 9, it was questioned whether it was the correct approach for that provision to single out only some issues that were to be referred to the law of the forum state of the insolvency proceedings. However, there was more support for the argument that the references to the matters governed by the law governing the insolvency proceedings in paragraph (4)(a) of Draft Principle 9 should not be overly broad in order not to endanger the harmonisation effort of the Draft Principles.

106. While some members of the Committee argued in favour of a broad reference in paragraph (4)(a) of Draft Principle 9 encompassing all avoidance grounds under the applicable insolvency law, the suggestion eventually found general support that paragraph (4)(a) of Draft Principle 9 should be redrafted by the Secretariat in order to match as closely as possible any grounds for an insolvency avoidance of a close-out netting provision that were not excluded by Draft Principle 7.

107. Concerning paragraph (4)(b) of Draft Principle 9, it was agreed that the Secretariat should redraft the provision in order to align it to any changes to be effected in relation to Draft Principle 8.

108. The Committee considered a suggestion to add the eligible parties and eligible obligations that were covered by paragraph (2) of the present Draft Principle 9 as a new letter (c) to paragraph (4) of Draft Principle 9, thereby providing that, in the event of the commencement of insolvency proceedings, the policy choices of the forum State concerning the determination of the scope of eligible parties and eligible obligations would prevail. While a number of delegates voiced support for that suggestion, several others opposed it for the same reasons set out above in the discussion referring to paragraph (2) of Draft Principle 9.

109. Moreover, concerns were raised that the addition of new elements to paragraph (4) could be understood as having a prescriptive meaning. It was asked to clarify whether that suggestion would have the consequence that enacting States were no longer able, even if they so wished, to

refer the determination of the scope of eligible parties and eligible obligations to the governing law of the close-out netting provision regardless of the commencement of insolvency proceedings. In response, it was noted that the intention was not to prevent the law of the forum from designating the *lex contractus* as the applicable law in case a insolvency proceeding was commenced.

110. This discussion was then summarized as follows: It was felt that at the present stage there was sufficient support for undertaking a redrafting of the present paragraph (4), which included a reference to the determination of the eligible parties and eligible obligations as being governed by the law of the insolvency proceedings. However, that reference should be drafted in such terms so as to refer only the issue of the enforcement of a close-out netting agreement in this regard to the law of the insolvency proceedings, but not the issue of the validity of the close-out netting agreement in respect of its conclusion in relation to such eligible parties and eligible obligations.

111. Some members of the Committee wondered what would be the consequences of this extension of Draft Principle 9(4) in a case where the obligations or parties concerned would be regarded as eligible for close-out netting under the law of the forum State of an insolvency proceeding, whereas the proper law of the close-out netting provision did not do so. Several members of the Committee referred to the general principle that a creditor could not acquire more extensive rights against the insolvent estate by reason of the commencement of the insolvency proceedings than those held by the creditor against the debtor prior to the commencement of the insolvency proceedings and argued that, from a contractual perspective, the close-out netting provision should not be given effect to in the insolvency proceedings in such a situation.

112. Finally, it was felt important to ensure that the current paragraph (4) of Draft Principle 9, and especially the inclusion of the eligible parties and eligible obligations into the scope of the issues governed by the law of the insolvency proceedings, would not be regarded as allowing any unequal treatment of foreign and domestic creditors. It was suggested that this could be achieved by referring to the obligation not to discriminate against foreign creditors which is laid down in the UNCITRAL Model Law on Cross-Border Insolvency. Moreover, it was stressed that, despite of the extension of the scope of application of the current paragraph (4) of Draft Principle 9, it should be ensured that the interpretation of close-out netting provisions, also in relation to the obligations covered, should continue to be governed by their own proper law, rather than by the law of the forum State of the insolvency proceedings.

Approval of the summary reports for 01 to 04 October 2012

113. The summary reports for the discussions that had taken place on 1, 2, 3 and 4 October 2012 (documents CGE/Netting/1/WP 08 to 11) and which covered the discussions reported above were approved, subject to amendments taken into account in this Report.

Agenda Items No. 4 and 5: Future work and any other business

114. Mr Estrella Faria informed the Committee that a second session of the Committee would be held in Rome, at the seat of the FAO, on 4-8 March 2013.

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ANNEX II**AGENDA**

(prepared by the UNIDROIT Secretariat)

1. Opening of the session and election of the Chairman
2. Adoption of the annotated draft agenda and organisation of the session
3. Consideration of the draft Principles regarding the enforceability of close-out netting provisions (UNIDROIT 2012 – C.G.E./Netting/1/W.P. 2 and Addendum)
4. Future work
5. Any other business.

ANNEX III

DRAFT PRELIMINARY PROPOSAL

Draft Principles 2 and 3

➤ **Principle 2 :**

« Eligible party » means :

- (a) a public authority,
- (b) a central bank, the Bank for International Settlements, a multilateral development bank, the International Monetary Fund or any similar entity,
- (c) a bank, a financial institution, an investment firm, or any similar professional financial market maker, in each case subject to regulation or prudential supervision,
- (d) an insurance or reinsurance company,
- (e) an investment fund,
- (f) a central counterparty, a clearing and/or settlement system,
- (g) a person other than a natural person,
- (h) a partnership or unincorporated association (whether or not its membership includes natural persons), or
- (i) any person designated by a State as an eligible party.

➤ **Principle 3****Principle 3: Definition of 'eligible obligation'**

"Eligible obligation" means an obligation arising under one of the following contracts when at least one of the parties is an eligible party mentioned under principle 2, a) to f) -

- a) derivative instruments
'derivative instrument' means an option, forward, future, swap, contract for differences or other transaction in respect of a reference value that is, or in the future becomes, the subject of recurrent contracts in the derivatives markets, whatever their underlying, including fungible commodities.
- b) repurchase agreements, lending agreements and margin loans, in each case for the purchase or sale of securities, money market instruments and units in collective investment schemes,
- c) title transfer collateral arrangements [related to other eligible obligations],
- d) contracts for the sale, purchase or delivery of
 - 1.- securities
 - 2.- money market instruments

3.- units in a collective investment scheme,

e) agreements under which a party undertakes (whether by way of surety or as principal debtor) to perform obligations assumed by another person under any agreement referred to in paragraphs [a] to [d].

If designated by a State: other transactions similar to (a) to (e); contracts for the sale, purchase or delivery of currency of any country, territory or monetary union; gold, silver, platinum, palladium, or any other precious metals, or any other fungible commodity; and rights to the return, or to payment or credit of the value, of property provided under a security interest or collateral arrangement.

If designated by a State, eligible obligations can include the contracts identified in a) to e) of this principle between eligible parties designated in g) to i) in principle 2.