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**UNIDROIT Committee of governmental experts  
on the enforceability of close-out netting  
provisions  
Second session  
Rome, 4 – 8 March 2013**

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C.G.E./Netting/2/W.P. 10  
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**Draft Principles regarding the  
enforceability of close-out netting provisions**

**COMMENTS**

*(submitted by Governments)*

**INTRODUCTION**

Subsequently to the comments (C.G.E./Netting/2/W.P. 8) and the joint proposal (C.G.E./Netting/2/W.P. 9) on the text of the UNIDROIT Draft Principles regarding the enforceability of close-out netting provisions (C.G.E./Netting/2/W.P. 2) and on a joint proposal submitted by the Governments of France, the United Kingdom and the United States of America concerning the principles on eligible parties and obligations (C.G.E./Netting/2/W.P. 4) for consideration by the Committee of Governmental Experts on the enforceability of close-out netting provisions at its second session from 4 to 8 March 2013, the UNIDROIT Secretariat received comments from the Government of the United Kingdom. These comments are reproduced hereunder.

**COMMENTS SUBMITTED BY MEMBER STATES**

***United Kingdom***

***General comments on Principles***

***Principle 1: Scope of the Principles***

We believe that it should be noted in the Commentary that the Principles do not impose a maximum field of harmonisation, and therefore do not prevent or restrict an implementing State from having a legal framework (whether by means of legislation or otherwise) that goes further or beyond the Principles in the area of the recognition or application and enforceability of close-out netting more generally (including, for example, without the necessity for any process of designation or election, and the absence of any restrictions on the identity of eligible parties or on the type of eligible obligations that may be the subject of close-out netting).

***Principle 2: Definition of 'close-out netting provision'***

It is unclear as to what is meant by the Principles not addressing 'truly' multilateral netting. Presumably, this means they do not address multilateral netting outside the limited context of central counterparties, net payment systems and clearing and settlement systems. Furthermore, it should be stated both in the key considerations and as a separate paragraph in the Commentary, that rights of set-off more generally, whether contractual or achieved under statutory provisions or by operation of law, and not connected with the operation of close-out netting, are not addressed or affected by the Principles. Close-out netting as dealt with in the Principles might be additional to such set-off rights but it does not replace or vary such rights as they may be available under national law.

We also believe that it should be stated in the Commentary that, whilst the Principles do not lay down any further specific requirements concerning the process of valuation for close-out netting, the ability of the parties to define the valuation mechanism may be subject to mandatory provisions of law in an implementing State intended to ensure that any such valuation mechanism is conducted in a commercially reasonable manner. The Principles do not prejudice the enforceability and operation of such provisions. This is consistent for example, with recital 17, second sentence of the EU Financial Collateral Directive.

***Principle 3: Definition of 'eligible party' / Principle 4: Definition of 'eligible obligation'***

These Principles are the subject of a separate new proposed text.

***Principle 5: Formal and Reporting Requirements***

It might be sensible to provide examples of other formal acts (i.e. not just registration), for example those referred to specifically in the context of the EU Financial Collateral Directive regarding the recognition of close-out netting provisions - article 7.2, cross-referring to article 4.4 - such as prior notice to effect termination or close-out, prior approval of a court needed for calculation of net payment, prescribed procedures for close-out mechanism, minimum stay periods).

***Principle 6: Operation of Close-out Netting Provisions in General***

Currently, the text states that the obligation on implementing States is to 'ensure that a close-out netting provision is enforceable in accordance with its terms' but subject only to the carve-outs for national law in the areas of fraud and the conditions for the validity of contracts set out in Principle 6.2. However, this appears to go further/contradict the text of the commentary in paragraph 94 where misrepresentation and fraud are given as examples ('such as') of fundamental rules of general application that are preserved.

***Principle 7: Additional Rules on the Operation of Close-out Netting Provisions in Insolvency***

Again, the effect of the current text is to only preserve the effect of certain limited aspects of insolvency law (fraudulent transactions/preferences). However, this appears to go further/contradict the text of the commentary (e.g. see the fourth 'key consideration' where it refers to an 'example' being that of fraud). Moreover, this approach goes further than that adopted in Article 7 of the EU Financial Collateral Directive, which was to recognise that close-out netting provisions should take effect in accordance with their terms 'notwithstanding the commencement of insolvency proceedings' but to recognise the continued application of 'requirements under

national law on bringing into account claims, on obligations to set-off, or on netting, for example relating to their reciprocity or the fact that they have been concluded prior to when the relevant party knew or ought to have known of the commencement (or of any mandatory legal act leading to the commencement) of insolvency proceedings' (recital 15 of the Directive).

More generally, the right approach seems to us to be that paragraph (1) of the Principle should set out the respects in which implementing States limit the application of mandatory provisions of their insolvency law that would otherwise apply, and paragraph (2) should confirm that, subject to this, they retain their normal freedom to apply such provisions in insolvency proceedings conducted under their laws (referring, if desired, reference to specific provisions as examples).

### ***Principle 8: Resolution of Financial Institutions***

The current text is limited to a 'carve-out' only for stays imposed as part of resolution measures. This is too narrow; all resolution measures that might be adopted should be outside the operation of the Principles. Similarly, the meaning of 'appropriate safeguards' should not be strictly limited to those as currently understood in the Key Attributes.

### ***Principle 9: Governing Law of Close-Out Netting Provisions***

The current text is complex and it is unclear whether some of the proposed provisions are intended to be declaratory of existing conflicts of laws rules or to change them. More generally, we question whether it is necessary or desirable for the Principles to attempt to deal comprehensively with the conflicts of laws rules applicable to close-out netting provisions, and are inclined to think that it would be preferable to address only those aspects of the conflicts treatment which may bear directly on the scope and effectiveness of the protection conferred by the Principles. This result of such a more restricted approach might, for example, be -

- (a) a general statement that the normal private international law rules of the implementing State relating to contractual obligations will apply to a close-out netting provision (arguably this could be dealt with in the commentary without a specific provision in the Principle);
- (b) a rule of recognition in insolvency proceedings (corresponding to the existing draft Principle 9(4)); and
- (c) a confirmation regarding the possible overriding application of insolvency rules applying the Principles in accordance with the law governing the relevant insolvency proceedings, corresponding to the existing draft Principle 9(5).

The precise drafting of these provisions would, of course, need to be agreed once a common view had been reached on the general approach of this Principle.