



Department
of Law

The Unidroit Principles on Close-out Netting

UNCITRAL Colloquium
December 2013

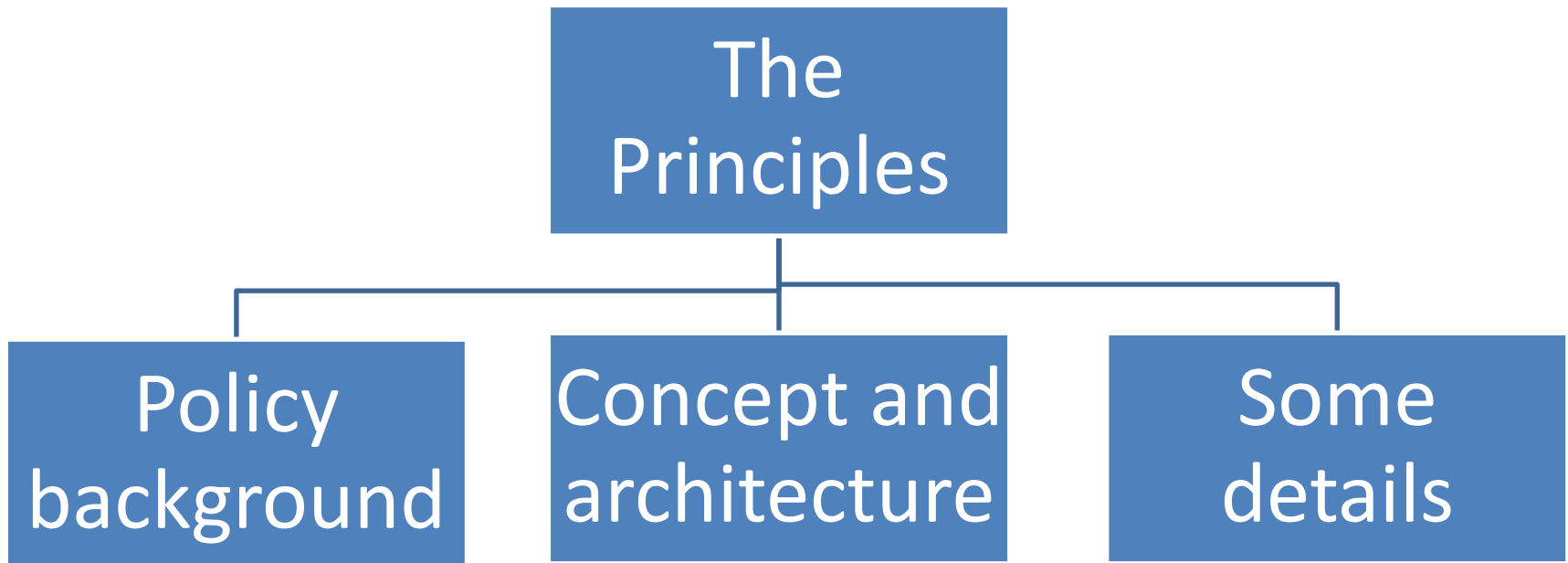
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The Unidroit Close-out Netting Principles

- 8 Principles with Commentary
- 2 sessions Governmental Conference
- Adopted March 2013
- 26 States + EU
- ECB + WB + BIS + IMF + EBRD + UNCITRAL + Hague
- Industry observers
- Preparations: Study Group (4 sessions), incl. Regulators, Practice, Academia, Fin. Industry

Mission:

Improve enforceability and legal certainty



Why does the world need them?

THE POLICY BACKGROUND

What is the purpose of the Principles?

Domestic view

- Netting-friendly law
- Liquidity / Safety
- Guidance

International view

- 2 or more jurisdictions
- Netting is sometimes unsafe
- Harmonisation
- Benchmark

What is the purpose of the Principles?

Domestic view

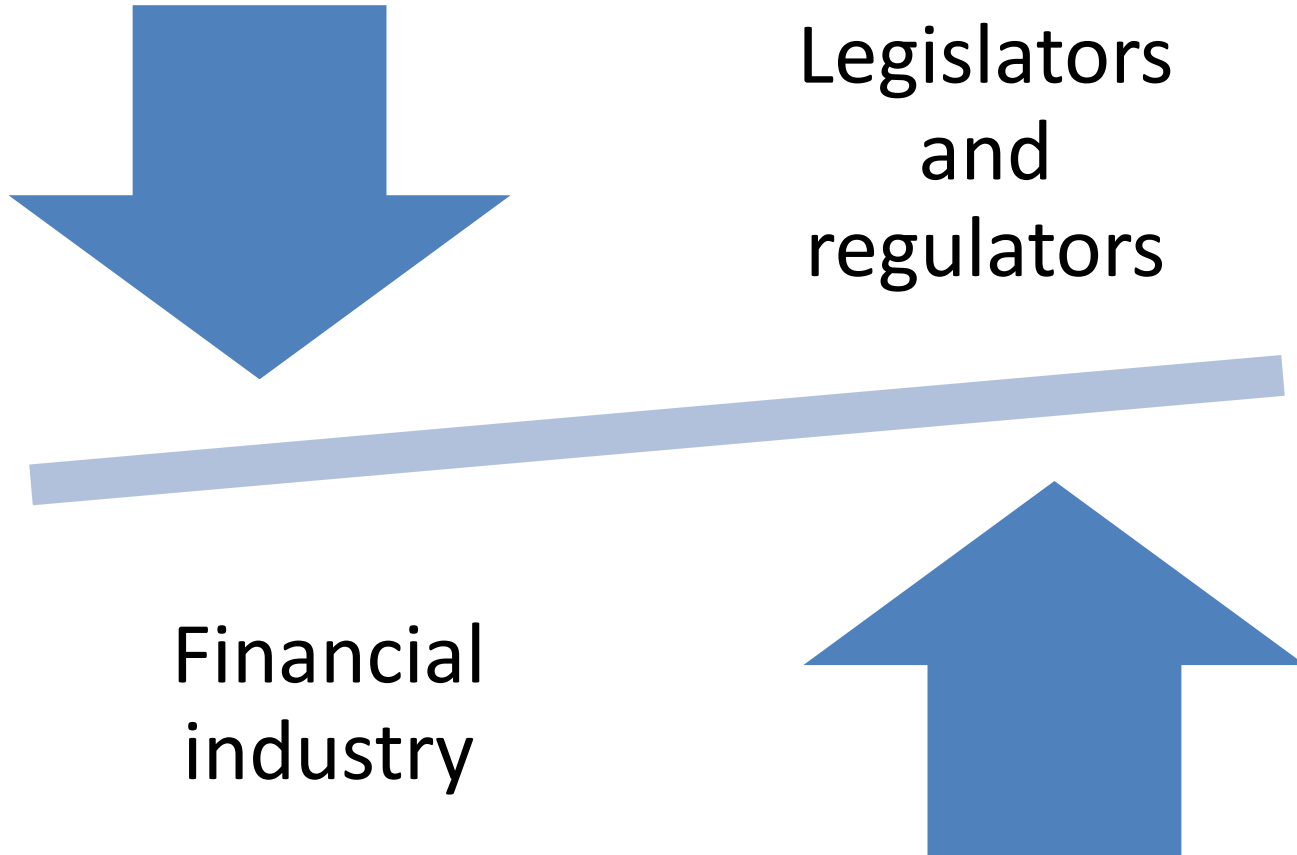
- Jurisdictions adopt netting friendly laws
 - Attractiveness of their financial market
 - Basel II: net risk means less capital is blocked as underlying capital and collateral
 - Close-out netting unavailable means close-out netting makes own financial institutions less attractive
- Netting friendly means that close-out netting works reliably.
- The Principles provide guidance on what it exactly needs to be 'netting friendly'.
- They are non-binding on jurisdictions.

What is the purpose of the Principles?

International view

- If a jurisdiction is netting-friendly, close-out netting works reliably in purely domestic situations.
- As soon as international elements are present (parties or their branches in different jurisdictions) insolvency proceedings could be opened in different jurisdictions.
- If the netting-agreement is geared towards the law of one jurisdiction, it might be unenforceable should insolvency occur in the other jurisdiction because the law may be different.
- Purpose 1: harmonisation of a number of fundamental parameters so that it becomes easier to comply with the law of all jurisdictions where insolvency proceedings could potentially be opened.
- Purpose 2: the principles serve as an international benchmark used by the financial industry and regulators

Who is the addressee/beneficiary ?



Addressee/beneficiary?

- Primary addressees are legislators wishing to make their laws netting-friendly. The Principles provide guidance.
- National and international regulators can use the principles as benchmark in the process of determining whether close-out netting used by the industry is legally robust in a given jurisdiction or cross-border.

Addressee/Beneficiary?

Are they industry-friendly?

- Yes ... but ...
- Yes – because the consolidation and harmonisation of standards of ‘netting-friendliness’ makes cross-jurisdictional close-out netting easier, cheaper and safer.
- But – the scope of close-out netting is *not* widened (as wished by the industry) as compared to an aggregate view of pre-existing netting-friendly regimes.
- Provides best practice legislative standard on the basis of current legal frameworks.

Main policy decision

Scope of close-out netting

- Within the confines of aggregate existing legal frameworks
- Certain types of parties entering certain types of contracts

Definition of close-out netting

- Functional and neutral
- Not tied to standard master agreements

Relation to insolvency

- Pari passu: netting *alone* is not a preference
- No cherry picking
- No stay (except bank resolution)

How do the Principles look like?

BASIC CONCEPT AND ARCHITECTURE

The basic logic

Close-out netting is a
Risk Mitigation Tool



Risk materialises at the moment
of insolvency and crisis.



Close-out netting agreements
must be ENFORCEABLE.

The 3 Principles on the scope

What
mechanism
exactly?

Who shall
benefit?

Which
transactions?

Principle 2

Principle 3

Principle 4

Definition
close-out
netting

Definition
eligible parties

Definition
eligible
transactions

Principles on enforceability



Privilege

Valid against
3rd parties

Pari passu
etc ?

The 4 Principles on enforceability

Formal
requirements

Certain typical
contract law
threats

Certain typical
insolvency law
mechanisms

Shall not
hamper
enforceability

Shall not
hamper
enforceability

Shall not
hamper
enforceability

Principle 5

Principle 6

Principle 7
Principle 8
(rule-exception)

SOME DETAILS ON ...

Personal and material scope

- Principles 3 and 4 intertwined
- Always in:
 - ‘Qualifying financial market participants’
 - Public authorities
- Other corporations when contracting with the aforementioned
- ... when entering into certain standard financial contracts (4.1.a), etc.
- Options for States to widen scope
 - In relation to non-financial corporations
 - In relation to other types of contracts
- Comparable to EU Financial Collateral Directive

Enforceability in insolvency

- Principles 7
- Generally disappplied:
 - Insolvency stay (7.1-a)
 - Cherry picking (7.1-b)
 - Avoidance for preferences (7.1-c)
 - Zero-hour and suspect period rules (7.1.-d)
- BUT: *actio pauliana* etc survive! (7.2)

Bank resolution powers

- Principle 8
- Provides that Principle 7 is without prejudice to regulatory stay and similar measures in the context of bank resolution
- Includes a reference to regulatory work (FSB Key Attributes)
- *Dynamic* reference

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Diagrams may be used provided the source is stated.