

P.R.I.M.E. Finance
Panel of Recognized International Market Experts in Finance

**New German netting legislation
following Federal Court of Justice decision of 9 June 2016**



P.R.I.M.E. FINANCE
Panel of Recognised International Market Experts in Finance



Presentation by Dr. Hendrik Haag, Hengeler Mueller, Frankfurt am Main

2017 P.R.I.M.E. Finance Annual Conference
23 & 24 January, Peace Palace, The Hague

German netting rules - general

- Special termination and liquidation regime for derivatives and other financial contracts traditionally accepted
- However, latent conflict between equal treatment of creditors and general rules for continuation of contracts (cherry picking) in insolvency and such special termination and liquidation regime
- Post crisis rising prejudice regarding financial sector privileges in insolvency scenarios



German netting rules – Financial Collateral Directive (FCD)

- German netting rules not fully in line with EU law framework
- Article 7(1) FCD provides that Member States shall ensure that a close-out netting provision can take effect in accordance with its terms notwithstanding the commencement or continuation of insolvency proceedings in respect of the collateral provider and/or the collateral taker
- Germany has been reluctant in implementing the FCD – various provisions, including Article 7(1) FCD, have not been (fully) implemented in Germany



Legal position prior to Federal Court of Justice decision of 9 June 2016

- Potential conflict between German statutory netting regime and contractual netting rules in master agreements for financial transactions
- General recognition of contractual netting rules in respect of collateralised transactions based on FCD requirements
- Recognition of contractual netting rules in respect of non-collateralised transactions within the boundaries of the German statutory netting regime
 - "safe harbor transactions"
 - treatment of "mixed" master agreements



Federal Court of Justice decision of 9 June 2016

Key points:

- Contractual netting rules in master agreements for financial transactions deviating from the German statutory netting regime are invalid
- Impact on timing of termination: contractual termination vs. opening of insolvency proceedings
- Impact on timing of valuation: contractual window of 5 BD vs. 2nd BD after opening of insolvency proceedings
- Impact on method of valuation: contractual methodology vs. "market or exchange price"



Amendment of German netting legislation (§ 104 InsO)

- Court decision caused major regulatory compliance issue because CRR recognizes only contract based netting (not statute based)
- Commitment of the German legislature to recognize contractual netting rules in master agreements for financial transactions
- Extension of catalogue of "safe harbor transactions"
- Recognition of certain contractual deviations:
 - timing of termination
 - timing of valuation



Remaining issues

- Catalogue of "safe harbor transactions"
- Article 7(1) FCD still not fully implemented in Germany
- Model-based valuation
- Treatment of "mixed" master agreements

