



EUROPEAN MONETARY INSTITUTE

OPINION OF THE EUROPEAN MONETARY INSTITUTE

on a consultation from the Finnish Ministry of Justice under Article 109f(6) of the Treaty establishing the European Community and Article 5.3 of the Statute of the EMI as elaborated in Council Decision of 22nd November 1993 (93/717/EC) on a draft proposal for an Act on certain terms in securities and foreign exchange transactions.

CON/97/06

1. The present consultation was initiated on 26 March 1997 by the Finnish Ministry of Justice which requested an opinion by 7 May 1997.
2. The EMI's competence to deliver an opinion is based on Article 1, section 1, fourth and fifth indents, of Council Decision of 22 November 1993 (93/717/EC) as the draft legislation concerns clearing and settlement operations, particularly netting in relation to securities, derivatives and foreign exchange transactions, and includes provisions aiming to enhance the stability of financial institutions and markets.
3. At the moment there is no specific law in Finland concerning netting in financial transactions. As a general rule, netting can be considered valid and binding under the law and legal doctrine of set-off. The proposed legislation is intended to secure legal certainty as regards netting in securities and foreign exchange transactions and to regulate certain special situations in an effective manner. The proposed Act would apply to securities, derivatives and foreign exchange transactions. Netting would be binding bilaterally between two parties or in a clearing organization on a multilateral basis provided the contractual netting terms are considered customary. So-called "close-out netting" or "default netting" would also fall within the scope of application. The proposed Act would not apply to payment transactions, but it is explained by the Finnish Ministry of Justice in a memorandum accompanying the draft Act that also netting in relation to payment systems could be included later.
4. Section 3 of the proposed Act provides that bankruptcy would not prevent the netting of obligations which have arisen prior to the initiation of bankruptcy proceedings. A clearing organization would be able to net the obligations which are entered into settlement before the

institution received information of the bankruptcy. Moreover, the proposed legislation includes provisions which would address the effectiveness of netting in relation to recovery in the event of bankruptcy and stay on payments to facilitate reorganisation of insolvent enterprises. The proposed Act also includes provisions to ensure inter alia the validity of netting in different types of insolvency proceedings of a credit institution.

5. The EMI welcomes the draft legislation as it enhances the soundness and effectiveness of clearing and settlement through netting in relation to securities, derivatives and foreign exchange transactions under Finnish law. The implementation of the proposed legislation would improve the legal situation as regards netting within the scope of application of the proposed Act and, thus, enhance the stability of financial markets and institutions.

6. The EMI notes that the scope of the proposed legislation does not extend to netting (or collateral) in relation to payment transactions, and it is assumed that this limitation of the scope of application will not create any legal uncertainty concerning existing rules on netting for areas not covered by the proposed Act. With reference to the current work in respect of the draft Directive of the European Parliament and of the Council on settlement finality and collateral security, the EMI notes, and would like to emphasise, the possibility to extend the application of the proposed Act to payment systems, which would provide an important enhancement of the efficient and smooth functioning of national and cross-border payment systems. Hence, an extended application of the proposed legislation in line with the draft Directive on settlement finality and collateral security will be welcome before the start of Stage Three of EMU.

7. The EMI agrees that this opinion may be made public by the competent Finnish authorities at their discretion.

30 April 1997