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Liechtenstein implements the Bank Recovery and Resolution Directive and Revises its Netting Legislation

As a Member State of the European Economic Area (EEA), Liechtenstein has to implement relevant European Union legislative acts that have been included in the EEA agreement. On 1 January 2017, the new Law on Recovery and Resolution of Banks and Investment Firms ('SAG')[1] implementing the Bank Recovery and Resolution Directive (Directive 2014/59/EU, hereinafter referred to as 'BRRD') entered into force. Simultaneously, clarifying amendments to provisions of existing domestic legislation concerning the validity and enforcement of close-out netting have been adopted. These amendments also entered into force on 1 January 2017.

The new law expands the scope of the provision that enables close-out netting in the insolvency of a Liechtenstein counterparty and removes existing uncertainties. In particular, the following changes have been implemented:

Scope

The former law had a narrow scope of application. The relevant provision validating close-out netting in the insolvency of a Liechtenstein counterparty, Article 33 (4) of the Bankruptcy Code,[2] only applied to certain transactions that qualified as financial transactions (*Verträge über Finanzleistungen*) and financial collateral arrangements within the meaning of Directive 2002/47/EC (the Financial Collateral Directive).

For this reason, certain derivative transactions such as physically settled over-the-counter commodity transactions were previously out of scope of Art. 33 (4) of the Bankruptcy Code. The validity and effectiveness of close-out netting with respect to these transactions was at best uncertain.

Under the new law, the scope of Art. 33 (4) of the Bankruptcy Code has been expanded to cover all of the following transactions:

- the transactions mentioned in Annex II of Regulation 575/2013 (the Capital Requirements Regulation);
- credit default swaps;
- transactions entered into under a standard master agreement for over-the-counter derivative transactions (including physically settled over-the-counter derivative transactions);
- securities lending and repurchase agreement transactions; and
- financial collateral arrangements.

As a result, the amended Art. 33 (4) of the Bankruptcy Code will now generally enable the early termination and netting of all transactions listed in Annex A to the International Swaps and Derivatives Association (ISDA) Master Agreements versions 1992 or 2002 in the insolvency of a Liechtenstein counterparty.

Under the former law, closed-out transactions had to be valued on the basis of estimate, market or exchange prices. There is no longer such a requirement under the new law. The contractually agreed valuation principles and methods can generally be relied upon in the insolvency of a Liechtenstein counterparty.

Clarifications

Under the former law it was unclear whether gaming laws would apply to certain types of cash-settled derivative transactions. The new law clarifies that gaming laws will not apply to a derivative transaction that has been entered into with a bank or under a standard master agreement for financial transactions.

A new provision has been inserted in the Bankruptcy Code that clarifies that the parties' right to terminate transactions under a standard master agreement for financial transactions does not infringe the trustee in bankruptcy's power to cherry pick. This explicit clarification confirms earlier case law.

Under the former law it was unclear whether banks that are not established and licensed

in the EEA can rely on the conflicts-of-law provision concerning netting agreements set out in Art. 60u of the Banking Act.[3] This provision is based on Art. 25 of Directive 2001/24/EC (the Banks Winding-Up Directive) and provides that in the insolvency of a Liechtenstein bank the governing law of the netting agreement will determine the validity and effect of close-out netting.

The new law clarifies that the conflict-of-law provision concerning netting agreements will only apply if the non-insolvent party is established in a Member State of the EEA or Switzerland.

As a result, if a Liechtenstein bank or investment firm enters into insolvency and the non-insolvent party is established in the EEA or Switzerland, the validity and effect of a netting agreement will be determined by the law governing the master agreement for financial transactions (eg, English law, if the parties have entered into an ISDA Master Agreement governed by English law).

On the other hand, a non-insolvent party established outside of the EEA or Switzerland will not be able to rely on this conflict-of-law provision. In their case, Liechtenstein insolvency law will determine the validity and effect of a netting agreement.

Other new provisions

Further amendments concerning collateral agreements clarify that out-of-court realisation is permitted for all types of collateral and the provision of substitution or top-up collateral, if previously agreed upon in the collateral agreement by the parties, is generally insolvency remote.

In order to facilitate the effective reorganisation of an insolvent bank or investment firm, a new provision in the Banking Act permits the court-appointed liquidator to opt for the continuation of a master agreement for financial transactions, provided the covered transactions will be continued in their entirety and the bank or investment firm continues to perform its obligations under the master agreement.

In addition, the SAG imposes restrictions on counterparties' rights to close-out, accelerate or otherwise terminate certain contracts, including master agreements for financial transactions, to facilitate the resolution and recovery of a failing bank or investment firm. The law provides that a crisis prevention or crisis management measure taken by the Liechtenstein Financial Markets Authority (FMA) in its capacity as resolution authority in relation to a bank or investment firm may not, per se, trigger termination or netting rights under a contract, provided that the obligations under the contract, including payment and delivery obligations and provision of collateral, continue to be performed.

The FMA has further resolution tools at its disposition to effectively deal with a failing institution under the SAG. To ensure appropriate protection of netting and collateral agreements from actions taken by the FMA, also with respect to regulatory capital treatment of exposures covered by a netting agreement for the purpose of the Capital Requirements Regulation, safeguards pursuant to Articles 75 to 80 of the BRRD have been implemented in the SAG.

Notes

1 Liechtenstein Law Gazette No 2016/493.
2 Liechtenstein Law Gazette No 1973/45.
3 Liechtenstein Law Gazette No 1992/108.