New comprehensive protection in Bulgaria for close-out netting arrangements in insolvency

Tsvetan Krumov writes on the new close-out netting law in Bulgaria that strengthens insolvency protections, broadens eligibility, and aligns conflict-of-laws rules with EU directives

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A comprehensive Bulgarian close-out netting law was promulgated on 15 August 2025. It is structured as an amendment and supplement to the Financial Collateral Arrangements Act (the "Amendment"), which transposed the EU Financial Collateral Directive 2002/47/EC (the "FCD") in Bulgaria. To reflect its broader scope, the title of the act was also changed to the "Financial Collateral and Close-out Netting Arrangements Act" (the "Act").

The structural approach of the Amendment introduces a new close-out netting regime, building on the well-established financial collateral concepts that have been applied and court-tested in Bulgaria for over 18 years. Furthermore, to define the scope of the new regime, the Amendment refers to the terminology according to the domestic transposition of the EU MiFID Directive 2014/65/EU (the "**MiFID**"), while the new general conflict-of-laws netting rule follows the wording under Article 25 of the EU Winding-up Directive 2001/24/EC (the "**WUD**") as transposed in Bulgaria. Such reliance on established concepts will hopefully facilitate the practical application of the Amendment.

What protections will the Amendment introduce for market participants?

So far, market participants have relied on complex and largely untested mechanisms, such as "automatic early termination" clauses, to "trigger" the effects of close-out netting before a "reorganisation measure" is adopted or "winding-up proceedings" against their Bulgarian counterparty commences (both latter terms in square brackets as defined under the Act in line with the FCD). Following the Amendment, parties acting within the scope of the Act will be able to terminate their transactions and benefit from the agreed close-out netting mechanism even after the adoption of "reorganisation measures" or the commencement of "winding-up proceedings" thus effectively escaping moratoriums and other insolvency restrictions.

Moreover, certain insolvency avoidance rules will be partially mitigated or displaced with respect to close-out netting, substantially following the rule in Article 8 FCD on financial collateral. In addition, a new rule displaces avoidance provisions invalidating pre-insolvency payments under obligations covered by close-out netting arrangements when made during certain suspect periods, thereby extending protection to the underlying obligations as well.

Other special protection rules for close-out netting arrangements include:

(i) a statutory reinforcement of the single-agreement concept, under which separate transactions covered by close-out netting arrangements may not be terminated individually but only as a whole; and
(ii) a prohibition on Bulgarian insolvency administrators from terminating governed by close-out-netting arrangements solely because winding-up proceedings have commenced.

To benefit from these protections, parties must ensure their arrangements fall within the scope of the Act, meaning:

(i) they meet the statutory definition of "close-out-netting provision";
(ii) both parties are eligible under the personal scope of the Act; and
(iii) the underlying obligations for which close-out netting applies are eligible under the subject-matter scope of the Act.

The most important scope-related rules will be briefly summarised in the following sections.

Definition of close-out netting provision

The same definition of "netting provision" under the Act – which has applied to financial collateral arrangements – will now also

apply to the new close-out netting regime introduced by the Amendment. That definition in turn substantially follows the wording of Article 2(1)(n) FCD. It is sufficiently broad to cover both mechanisms where "values" of terminated transactions are compared to calculate close-out amounts under the ISDA Master Agreement, as well as classic set-off mechanisms with respect to obligations that have become due prior to termination (e.g. unpaid amounts under the ISDA Master Agreement or obligations under GMRA repurchase or GMSLA securities lending transactions).

As with the relevant definition, the trigger for the close-out netting arrangements will be the "enforcement event" (as per the local transposition of Article 1(2)(l) FCD), which has so far applied only to financial collateral, referring in turn to an event of default or "any similar event" as agreed between the parties.

Subject-matter scope of the Act

The Act employs the linguistically identical term "financial obligations" to denote both the obligations secured by financial collateral (referred to in here as "**Collateral Financial Obligations**") and the obligations for which close-out netting applies (referred to as "**Netting Financial Obligations**"). Since the actual definitions differ significantly, the two key concepts under the Act have a notably different subject-matter scope.

The definition of Collateral Financial Obligations under the Act, following Article 2(1)(f) FCD, employs a functional approach, referring to obligations that may be settled by cash payment or delivery of financial instruments. This functional description covers a broad range of transactions, provided they can be executed in the prescribed manner.

Conversely, the definition of Netting Financial Obligations covers obligations under a limited number of specific transactions. These include, first, all derivatives transactions under the MiFID implementation in Bulgaria. This is modified by displacing any requirements in the relevant derivatives transactions' definitions "to be dealt in on a trading venue", thus expanding the subject-matter scope for commodity and economic statistics derivatives. Netting Financial Obligations also include obligations under securities and certain other financial instruments according to the domestic MiFID implementation, documented in "repurchase, securities lending and any other types of transactions". Lastly, Netting Financial Obligations cover obligations secured by or under financial collateral arrangements.

Personal scope of the Act

Following the Amendment, the Act now also has two separate sets of rules for the eligible counterparties (personal scope) – one for financial collateral arrangements and another for close-out netting arrangements.

The personal scope for financial collateral arrangements covers all specific sovereign and financial entities listed in Article 1(2)(a–d) FCD, extended in Bulgaria by some financial

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institutions not listed in the FCD (hereinafter referred to as "**Professional Counterparties**"). Furthermore, the Amendment extended the eligible counterparties to persons "having the capacity of any of the listed ones, under the law of another state". As a result, there is now no doubt that banks and other entities having the characteristics of Professional Counterparties as per the Act's statutory list under the law of a non-EEA state are eligible.

Furthermore, the Act makes other "legal persons" eligible if they deal with any of the Professional Counterparties.

The personal scope for close-out netting arrangements substantially mirrors the personal scope for financial collateral arrangements. However, for the purposes of close-out netting, the list is extended to include *inter alia* persons allowed by law to deal in eligible Netting Financial Obligations. Given that the latter term is defined primarily by reference to MiFID financial instruments, the MiFID rules regarding who is eligible to deal in MiFID financial instruments – including exceptions allowing dealings without a licence – should be primarily considered. The purpose behind that personal scope extension is to introduce specific scenarios (mainly due to MiFID exceptions for non-regulated corporate entities to deal in MiFID financial instruments without a licence) involving "corporate-to-corporate" derivatives transactions or MiFID securities deals under the close-out netting protection of the Act.

Conflict of laws netting rule

Article 25 WUD is transposed verbatim in Bulgaria under the special domestic laws regulating credit institutions and MiFID investment firms, and those transpositions are not affected by the Act.

The Amendment replicates these Article 25 WUD transpositions, establishing a new, separate rule applicable to matters under the Act by the following wording:

> *"upon application of reorganisation measures or the commencement of winding-up proceedings in Bulgaria the law governing close-out netting shall be the law governing the agreement".*

In addition, the scope of that new rule is clarified by expressly covering specific aspects where most importantly insolvency avoidance rules under *lex contractus* will apply instead of the relevant Bulgarian laws. This last clarification merits some special attention.

As the new rule in the Act mirrors the transposition of Article 25 WUD for credit institutions and MiFID investment firms (being particularly important for legal opinions), the above clarifications may in fact support a broader interpretation of the transposition rules for credit institutions and investment firms. This is further reinforced by:

(i) the history of Article 25 WUD at the EU level, discussed in the next paragraph, and
(ii) the prior acceptance of a broader interpretation of Article 25 WUD by Bulgarian authorities, reviewed in the paragraph following that.

In terms of wording, Article 25 WUD (and Article 26 on repurchase agreements as well as Article 27 on regulated markets) have no analogue in the EU Insolvency Regulation (EU) 2015/848 (the "**EIR**"). Its "unusual" wording therefore results in various interpretations (summarised in several public papers of ISDA) that are either too narrow (e.g. not being an exception to *lex fori concursus* at all, which contradicts Recitals 23 and 24 of the WUD's Preamble) or too broad (e.g. displacing any otherwise applicable insolvency law – rendering Article 25 WUD a substantive rule which, however, is incompatible with the structure of the EU substantive rules ringfencing certain relations from the effects of insolvency as the *rights in rem* rules in the WUD and EIR).

The history of Articles 25, 26 and 27 of the WUD – whose relevance when being adopted was discussed exclusively in the context of the EU Settlement Finality Directive (98/26/EC) (the "**SFD**") as displayed in the relevant preparatory documents – and their actual wording clearly show they are meant to follow Article 8 SFD, which is also not worded as the classic insolvency conflict of laws rules under the EIR. Article 8 SFD provides that "in the event of insolvency proceedings being opened against a participant in a system, the rights and obligations arising from, or in connection with, the participation of that participant

will be determined by the law governing that system" and as per Recital 17 of the SFD's Preamble is construed as intended to replace all substantive insolvency laws (including avoidance rules) under *lex concursus* with those under the law of the relevant system. So, Article 25 WUD should be interpreted in a similar manner.

This broader interpretation of the local transposition of Article 25 WUD was tested in the context of the insolvency of a large Bulgarian bank – Corporate Commercial Bank AD (CCB) – which commenced in 2014, when we represented a counterparty to CCB under multiple transactions under the 2002 ISDA Master Agreement governed by New York law. The agreement was terminated not upon the occurrence of the restructuring event (due to unfavourable rates at that time) but four months later and, according to the restructuring laws then applicable in Bulgaria, had to be approved by the Bulgarian National Bank (BNB).

The BNB adopted the analysis, drawing a parallel with Article 8 SFD. Subsequently, the same analysis was adopted by the CCB's insolvency administrators, who did not invoke a special bank insolvency avoidance rule that would invalidate any set-off after the initial bankruptcy event. That was relevant, as upon termination of the transactions in that case, the calculated early termination amount included set-off against a substantial default rate amount and was challengeable but was never disputed within the applicable time-barring periods.

Despite the above practice, given that important member states (as France and Germany, as well as the UK that retained its Article 25 WUD's transposition after BREXIT) have implemented Article 25 limiting it only to the "effects of" winding-up proceedings or restructuring measures, and the prevailing view among experts that Article 25 WUD does not cover avoidance rules, a conservative approach excluding avoidance rules has been taken in Bulgarian opinions on the local transposition of Article 25 WUD that is most often analysed for the purposes of legal opinions.

Summary

Given the statutory clarification that the conflict of laws rule under the Act explicitly subjects the insolvency avoidance rules to the law governing the agreement – and noting that, apart from the clarifications, this rule is the same as the local implementation of Article 25 WUD, the latter's meaning should be reconsidered in Bulgarian legal opinions. ■

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