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**Attn: Dr. Peter M. Werner  
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Zagreb, January 13<sup>th</sup>, 2012

**Reference: Legal Memorandum on 1992/2002 ISDA Master Agreement (“the ISDA Master Agreement”) - revised update**

**This Legal Memorandum does not constitute a legal opinion with respect to any issues set forth herein. Its intent is merely to provide a guide for the ISDA members with respect to ISDA related issues under Croatian law. It may not be used as an opinion for banking regulatory purposes administering capital adequacy provisions.**

This Legal Memorandum should be read in conjunction with the ISDA letter addressed to Croatian Ministry of Finance (and cc: to the Croatian National Bank and Croatian Banking Association) dated June 24th, 2011 available here: [http://www2.isda.org/attachment/MzM3MQ==/HR\\_ISDA\\_Ltr\\_MoF\\_CroatEngl\\_Jun11\\_Final.pdf](http://www2.isda.org/attachment/MzM3MQ==/HR_ISDA_Ltr_MoF_CroatEngl_Jun11_Final.pdf) (“the ISDA letter”).

For the matter of convenience, this Legal Memorandum replaces all our previous memorandums provided to ISDA in order to facilitate its reading. Certain important issues are analysed in more detail, whereas some less significant legal matters are presented as short summaries.

This Legal Memorandum has been provided under the assumption that parties to the ISDA Master Agreement enter into a number of Derivatives Transactions, where one party has its registered office outside Croatia and the other party has its registered office in Croatia (hereinafter referred to as: the “Croatian party”). Such Derivatives Transactions include any or all of the transactions described in Appendix A to this Legal Memorandum and constitute valid transactions enforceable in accordance with their terms under all applicable laws (including the laws of the Republic of Croatia).

This document is structured in four parts: I. Political Framework, II. Derivatives and Netting Related Issues, III. Financial Collateral Summary and IV. Pending Legal Developments.

## **I. POLITICAL FRAMEWORK**

Shortly after the Parliamentary elections took place in early December 2011, Croatia signed the Accession Agreement confirming its commitment to become the next EU Member State. The new left wing coalition Government was constituted before Christmas and the Parliament passed a decision that the EU referendum shall be scheduled for January 22<sup>nd</sup>, 2012. It is estimated that Croatia shall join the EU on July 1<sup>st</sup>, 2013.

In light of the described political developments and the EU membership perspectives related thereto, it should be noted that Croatia has undertaken significant steps to comply with EU regulations for several years now. In that period and while working on the harmonisation of the Croatian legal system with the EU Directives, the Croatian Parliament passed a number of provisions that are currently still suspended<sup>1</sup>, but should come into force the moment Croatia joins the EU. Since there is almost a year and a half before it is expected Croatia shall join the EU, the suspended provisions shall not be elaborated in this Legal Memorandum as they are not yet in force and as such, may be amended or changed in the meantime.

## **II. DERIVATIVES AND NETTING RELATED ISSUES**

### **II.1 DEFINITION OF DERIVATIVES – GENERAL OVERVIEW**

Croatian law recognises Derivatives Transactions, both the OTC derivatives as well as the exchange traded derivatives.

A definition of “derivatives” is provided in Article 3 (1) 2d. of the Capital Markets Act<sup>2</sup> as follows:

“2.d. derivatives, that include:

- options, futures, swaps, forward rate agreements and all other financial derivative instruments that are related to securities, currencies, interest rates or incomes, and other financial derivative instruments, financial indexes or financial measures that can be settled either physically or in cash,
- options, futures, swaps, forward rate agreements and all other financial derivative instruments that are related to commodities, whereby such agreements have to be settled in cash or can be settled in cash upon the request of the one of the (contracting) parties (except from the reason of the non – payment or other default reasons for the termination of the contract);

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<sup>1</sup> Such as the "passporting rules" applicable for providing financial/investment services and ancillary investment services in the territory of the Republic of Croatia. The passporting rules shall come into act the moment Croatia joins the EU.

<sup>2</sup> Official Gazette No. 88/08, corr. 146/08, 74/09

- options, futures, swaps, forward rate agreements and all other financial derivative instruments that are related to commodities, whereby such agreements can be settled physically, under the condition that such derivatives are traded either on the regulated market and/or on the multilateral trading platform,
- options, futures, swaps, forward rate agreements and all other financial derivative instruments that are related to commodities, whereby such instruments are not listed under line 3 of Sub item d. of this item and they do not have any commercial purpose, that they have characteristics of other financial derivative instruments, taking into consideration the fact either that they are being cleared and settled by the recognised clearing houses or they are related to the regular margin call,
- derivative instruments with the purpose of transferring the credit risk;
- financial contracts for differences,
- options, futures, swaps, forward rate agreements and all other financial derivative transactions that are related to climatic variables, transfer fees, emission quotes of inflation rates or other official economic statistical data, and have to be settled in cash or can be settled in cash upon the request of one of the (contracting) parties (except from the reason of the non – payment or other default reasons for the termination of the contract), together with all other financial derivative instruments that are related to property, rights, obligations, indexes and measures that are not stated hereunder and also contain characteristics of other financial derivatives instruments, specifically taking into consideration whether such instruments are traded on an organised market and/or on a multilateral trading platform or are cleared and settled by the recognised clearing houses or they are related to the regular margin call.”

Besides the aforementioned definition, other Croatian laws and by-laws also recognise derivatives (transactions) such as the Credit Institutions Act<sup>3</sup>, numerous by-laws passed by the Croatian National Bank related to the capital adequacy issues applicable to the credit institutions, the Insurance Act<sup>4</sup> and related by-laws, the Investment Funds Act<sup>5</sup> and related by-laws etc.

## II.2 ENFORCEABILITY OF OTC DERIVATIVES TRANSACTIONS; GAMING/GAMBLING

We are of the opinion that currently there are no specific enforceability problems regarding the OTC derivatives transactions (hereinafter referred to as: the “Derivatives Transactions”). Pursuant to Croatian law, Derivatives Transactions would be qualified as contracts and therefore general contractual rules provided in the Obligation Code<sup>6</sup> would be applicable (under the assumption that Croatian law would be the governing law to such transactions).

The execution, delivery and performance of the Derivatives Transactions do not violate and are not in conflict with any Croatian law. However, certain types of

<sup>3</sup> Official Gazette No. 117/08, 74/09, 153/09

<sup>4</sup> Official Gazette No. 151/05, 87/08, 82/09

<sup>5</sup> Official Gazette No.150/05

<sup>6</sup> Official Gazette No. 35/05, 41/08

Croatian parties, such as investment funds, pension funds and insurance companies, may be restricted from entering into derivatives transactions under certain circumstances. Such restrictions are mainly based on the investment limitations and/or entering into Derivatives Transactions for hedging purposes. If any of the aforementioned Croatian parties breach any such provisions, all such transactions would remain valid and enforceable, whereas the Croatian party may be penalised (monetary fine) for such breach by the local authority.

The Obligation Code also does not contain any specific provision dealing with gambling/gaming. It also does not consider such contracts as null and void.

Please note that there is no court practice in respect of Derivatives Transactions in Croatia at this moment and therefore there are still some pending legal issues that need to be clarified by the future amendments of certain laws and/or supported by the court practice, some of which are also mentioned in this Legal Memorandum.

### II.3. FOREIGN LAW GOVERNED CONTRACTS (ENGLISH LAW / NEW YORK LAW); JURISDICTION OF FOREIGN COURTS (ENGLISH COURTS / NEW YORK COURTS) / ARBITRATION

The choice of English law or New York law and submission to the non-exclusive jurisdiction of the English or New York court would be valid under Croatian law.

According to Article 19 of the Law on Conflict of Laws<sup>7</sup>, the law governing contracts is (considered to be) the law that the contracting parties have selected, unless otherwise provided by law or an international treaty.

Pursuant to Article 4 of the Law on Conflict of Laws, a foreign law shall not apply if the effect of such law would be contrary to the Constitution of the Republic of Croatia. Furthermore, Article 5 of the Law on Conflict of Laws provides that a foreign law (that would be the governing law pursuant to the provisions of the Law on Conflict of Laws) would not be applicable if the purpose of the application of such law would be the circumvention of the application of Croatian laws. There is currently no court practice that would qualify the effect(s) of English/New York law arising out of the ISDA Master Agreement to be contrary to the Croatian Constitution nor that the selection of the mentioned governing laws by the parties would be for the purpose of the circumvention of the application of Croatian laws. We are of the opinion that the selection of English/New York law to the ISDA Master Agreement is a standard market practice due to the historical development of Derivatives Transactions that, as a consequence thereof, resulted in a parallel development of sophisticated derivatives regulation recognised by the financial markets participants entering into cross-border Derivatives Transactions. We also believe that the Croatian court would support this argument for the valid selection of English/New York law as the governing law to the ISDA Master Agreement.

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<sup>7</sup> Official Gazette No. 53/91 (including the Arbitration Act, Official Gazette No. 88/01); The Law on Conflict of Laws dates from July 15th, 1982 and has been adopted by the Republic of Croatia in 1991, after former Socialistic Federative Republic of Yugoslavia became dissolute. On the other hand, the Arbitration Act that applies to the recognition and enforcement of arbitral awards dates from 2001 and contains slightly more sophisticated provisions than the Law on Conflict of Laws

English/New York court decisions, together with other court decisions reached by the relevant courts other than the courts of the Republic of Croatia, are enforceable under Croatian law.

According to Article 86 of the Law on Conflict of Laws, a decision of the foreign court shall be treated as equal to the decision of the Croatian court and shall have the same legal effect in the Republic of Croatia if such decision (of the foreign court) has been recognised by the Croatian court.

Pursuant to the Law on Conflict of Laws, the main conditions for the recognition and the consequent enforcement of a foreign judgement in Croatia are:

- That the applicant has submitted evidence issued by a competent foreign court evidencing that the judgement has become final in accordance with the laws of the country of its origin;
- That no objection by the person against whom the foreign judgement has to be enforced has been made to the effect that such person was denied the right to participate in the proceedings due to violations of the rules of proceedings;
- That the Croatian court has no exclusive jurisdiction concerning the subject matter;
- That in the same matter the Croatian court or any other court has not passed a final judgement;
- That the foreign judgement is not contrary to Croatian public policy;
- That reciprocity exists (pursuant to either a treaty or the “actual reciprocity”).

In case the parties agree to arbitration, pursuant to the provisions of the Arbitration Act<sup>8</sup>, a foreign award will be recognised in the Republic of Croatia under the following conditions:

- If a legally valid and binding arbitration agreement was concluded,
- If a party in such recognition proceeding had capacity to enter into an arbitration agreement, to be a party in a dispute (that was subject to the award to be recognised) and if such party was duly represented during the arbitration proceeding,
- If a party that filed a claim for declaring an arbitral award as null and void was duly informed on the commencement of the arbitration proceeding and such party was able to participate in such proceeding before the arbitration body,
- If the arbitral award is related to the dispute that is subject to the arbitration agreement, that such award does not contain decisions that are beyond the scope of the arbitration agreement etc.,
- If the constitution of an arbitral body and the arbitral proceeding were in accordance with the Arbitration Act or the (arbitration) agreement entered between the parties,
- If the arbitral award contains exposition (explanation) and is duly signed,
- If the case could be tried before the arbitration according to the laws of the Republic of Croatia,
- If the recognition of such award is not contrary to the Croatian public policy (public order),
- If the arbitral award has become final to the parties,

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<sup>8</sup> Official Gazette No. 88/01

- If the court of the foreign country in which such award was made (i.e. the country of origin) or the court of the foreign country by whose laws such award was made has neither nullified such award nor postponed the effect of such award,
- If the applicant has submitted the following documents:
  1. the application for recognition of the arbitral award,
  2. the arbitral award (either the original or a verified copy),
  3. the arbitration agreement (either the original or a verified copy),
  4. if documents stated under 2. and 3. above are not in Croatian language, a translation into Croatian language verified by a sworn court interpreter should be enclosed as well.

The recognition of an arbitral award is similar to the proceeding for recognition of the foreign judgement before Croatian court.

#### II.4 TELEPHONE RECORDING

Although there is no explicit provision under Croatian law prescribing this legal issue, there is a precedent of the Supreme Court of the Republic of Croatia, Rev-x 35/98-2 as of 18.03.2009, stating that a recorded telephone conversation may not be used as evidence in a civil litigation process if there was no consent given by the other party for the telephone call to be recorded or if the other party was not aware of such recording. The Supreme Court also ruled that the Croatian Constitution grants freedom and confidentiality of correspondence and all other similar communication, whereas such freedom may not be violated, unless when prescribed by law and when it is necessary to protect the security of the state or for any reason related to a criminal prosecution. It also states that a telephone conversation is considered to be a secret and confidential means of mutual communication and is therefore protected by the Croatian Constitution as described above.

Therefore, we are of the opinion that prior consent from the Counterparty is required and that such consent may be general and set out in the relevant ISDA Master Agreement.

#### II.5 SINGLE AGREEMENT

In our opinion, the Croatian court would support a single agreement concept as provided under the ISDA Master Agreement.

There is also no risk of nullity of the entire ISDA Master Agreement in case of nullity of a single provision. According to Article 324 of the Obligation Code, nullity of a certain provision of an agreement does not have a nullity consequence of the entire agreement if such agreement can survive without such null and void provision and if such provision was neither a condition nor a deciding incentive for the conclusion of such agreement. Such agreement shall also remain legally valid even in case such null and void provision was either a condition or a deciding incentive if such nullity was determined for the purpose that the agreement would be legally valid without such provision.

## II.6. FOREIGN EXCHANGE REGULATION

There are currently no relevant foreign exchange restrictions that would prevent Croatian parties from entering into Derivatives Transactions.

## II.7 TAX, STAMP DUTIES, LEVIES

There are neither tax, stamp duties nor levies, including the registration, documentation or similar taxes, duties or levies payable in connection with the execution, delivery or performance of the Derivatives Transactions and/or the ISDA Master Agreement or its admissibility in evidence.

## II.8 INSOLVENCY / BANKRUPTCY LAWS OF CROATIA; TERMINATION BY NOTICE (LEGAL DISCREPANCY BETWEEN ARTICLE 111 OF THE BANKRUPTCY ACT<sup>9</sup> AND ARTICLE 8 OF THE FINANCIAL COLLATERAL LAW) / AUTOMATIC EARLY TERMINATION AND OTHER RELATED ISSUES

### II.8.1 INSOLVENCY / BANKRUPTCY LAWS OF CROATIA

Insolvency/bankruptcy proceedings in the Republic of Croatia are regulated in several laws.

Please find below a list of the insolvency/bankruptcy related regulation including some essential characteristics of such laws with an emphasis on Derivatives Transactions and netting, where applicable.

#### II.8.1.1 BANKRUPTCY ACT

Basic law that regulates bankruptcy proceeding (Croatian:“stečajni postupak”). Originally, the Bankruptcy Act was drafted as a mirror copy of the German Bankruptcy Act (Insolvenzordnung, as of 1994 version), and therefore it contains the majority of the Insolvenzordnung’s provisions and principles.

Pursuant to Article 4 (3) of the Bankruptcy Act, a bankruptcy proceeding can be commenced against all types of entities except the following:

- a) the Republic of Croatia,
- b) funds that are financed from the budget of the Republic of Croatia, pension funds of employees and funds for employees with special needs,
- c) individual entrepreneurs and individual agricultural workers,
- d) Croatian Office for Health Insurance and
- e) local municipalities.

For entities whose business activity is in production of weapons and military equipment respectively providing services to the Croatian Army, bankruptcy

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<sup>9</sup> Official Gazette No. 44/96 (Banking Act, Official Gazette No. 161/98), 29/99, 129/00, 123/03, Decisions on the Amendments to the Bankruptcy Act Official Gazette No. 197/03 and 187/06, 82/06, 116/10

proceeding can be commenced only with a prior consent of the (Croatian) Ministry of Defence.

The Bankruptcy Act regulates the following issues:

1. Terms and conditions for commencing bankruptcy proceeding (such as: i) insolvency (“inability to pay”) or ii) (indebtedness), bankruptcy proceeding itself and legal consequences and execution thereof;
2. Bankruptcy plan;
3. Personal management of an insolvent debtor (a debtor that is not capable to pay);
4. Terms and conditions under which a debtor can obtain a relief of his obligations.

The Bankruptcy Act contains one provision dealing with netting (Article 111). More details regarding Article 111 of the Bankruptcy Act are provided further in this Legal Memorandum.

#### II.8.1.2 CREDIT INSTITUTIONS ACT

Deals with credit institutions partially regulating their bankruptcy proceeding. Still, the majority of provisions of the Bankruptcy Act shall apply to credit institutions as well. Please note that there are certain provisions in respect of the international bankruptcy issues and netting related to credit institutions that do not apply to credit institutions at this moment. Such provisions (such as Article 353 of the Credit Institutions Act, as elaborated in the ISDA letter) will apply from the moment the Republic of Croatia becomes a member of the European Union.

Please find below all insolvency/bankruptcy proceedings Croatian credit institutions/banks can be subject to:

I. Appointment of a trustee by the Croatian National Bank (Croatian: “imenovanje povjerenika Hrvatske narodne banke”) - regulated by the Credit Institutions Act, Article 238 ff.;

II. Appointment of a special management board by the Croatian National Bank (Croatian: “imenovanje posebne uprave”) – regulated by the Credit Institutions Act, Article 241 ff.;

III. Appointment of a special management and reorganisation of business of a third country bank’s (credit institution’s) branch office (established in the Republic of Croatia) by the Croatian National Bank (Croatian: “uvođenje posebnog rukovodstva i reorganizacija poslovanja kreditne institucije iz treće države”) – regulated by the Credit Institutions Act, Article 254 ff.;

IV. Ordinary liquidation (Croatian: “redovita likvidacija”)– regulated by the Credit Institutions Act, Article 258 ff.;

V. Compulsory liquidation (Croatian: “prisilna likvidacija”)– regulated by the Credit Institutions Act, Article 263 ff.;



VI. Liquidation of a third country bank's (credit institution) branch office (established in the Republic of Croatia) (Croatian: "likvidacija podružnice kreditne institucije iz treće države") – regulated by the Credit Institutions Act, Article 271 ff.;

VII. Bankruptcy proceeding (Croatian: "stečajni postupak" or "stečaj") – regulated by the Credit Institutions Act, Article 272 ff. and the Bankruptcy Act.

#### II.8.1.3 INSURANCE ACT

Contains a modest number of provisions related to the bankruptcy of insurance companies (Articles 219 – 227). The Insurance Act reverts to the Bankruptcy Act as to the main source of the bankruptcy regulation of insurance companies. Insurance companies are subject to the following insolvency/bankruptcy proceedings:

I. Ordinary liquidation (Croatian: "redovita likvidacija") – regulated by the Insurance Act, Article 200 ff.;

II. Liquidation of a mutual insurance company (Croatian: "likvidacija društva za uzajamno osiguranje") – regulated by the Insurance Act, Article 204

III. Compulsory liquidation (Croatian: "prisilna likvidacija") – regulated by the Insurance Act, Article 205 ff.;

IV. Bankruptcy proceeding (Croatian: "stečajni postupak" or "stečaj") – regulated by the Insurance Act, Article 219 ff. and the Bankruptcy Act

Certain provisions related to the ordinary and compulsory liquidation shall come into force on the day the Republic of Croatia becomes a member of the European Union.

#### II.8.1.4 CREDIT UNIONS ACT

Similar to the Insurance Act, this Act reverts to the Bankruptcy Act as to the main source of the bankruptcy regulation of credit unions.

#### II.8.1.5 LEASING ACT

Reverts only to the Bankruptcy Act as to the main source of the bankruptcy regulation of leasing companies.

#### II.8.1.6 COMPANY ACT<sup>10</sup>

Applies to all Croatian entities established in a form of a company (such as ordinary companies, credit institutions, insurance companies etc.). It regulates "liquidation", which is a voluntary dissolution of a company (Croatian: "likvidacija").

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<sup>10</sup> Official Gazette No. 111/93, 34/99 – Decision of the Constitutional Court of the Republic of Croatia, 52/00, 118/03, 107/07, 146/08, 137/09

It has to be noted, that besides liquidation, Companies are also subject to the bankruptcy proceeding which is a compulsory dissolution of a company, (Croatian: “stečajni postupak” or “stečaj”) regulated by the Bankruptcy Act.

We are of the opinion that the term “Bankruptcy” (listed as an Event of Default pursuant to Section 5 (a) (vii) of the ISDA Master Agreement) covers all possible insolvency/bankruptcy proceedings of all types of Croatian Counterparties.

## II.8.2 TERMINATION BY NOTICE / AUTOMATIC EARLY TERMINATION (LEGAL DISCREPANCY BETWEEN ARTICLE 111 OF THE BANKRUPTCY ACT AND ARTICLE 8 OF THE FINANCIAL COLLATERAL LAW)

### II.8.2.1 TERMINATION BY NOTICE

Termination by notice would be enforceable pursuant to the ISDA Master Agreement provisions in respect of the following types of Croatian parties:

- a) all Croatian entities that are not subject to the Bankruptcy Act (please see under II.8.1) and
- b) all other Croatian entities under the assumption that an Early Termination Date falls before an institution of a bankruptcy proceeding as defined by the Croatian Bankruptcy Act (“stečajni postupak” or “stečaj”)<sup>11</sup>. If, however, an Early Termination Date falls after an institution of bankruptcy proceeding (assuming that Automatic Early Termination is not selected), in such case it is not clear whether the provisions of the ISDA Master Agreement or the provisions of the Croatian Bankruptcy Act shall prevail because of the legal discrepancy between Article 111 of the Bankruptcy Act and Article 8 of the Financial Collateral Law, as elaborated in the ISDA letter. For the matter of convenience, please find below a short summary of the mentioned discrepancy and potential consequences arising thereof.

Assuming the parties have not selected Automatic Early Termination to apply in relation to the Croatian counterparty, then under Section 6(a) the Non-defaulting Party is entitled to give notice designating an Early Termination Date upon the occurrence of Bankruptcy - Section 5(a)(vii) (1), (2), (3), (4) (excluding bankruptcy proceeding in terms of the Bankruptcy Act), (5), (6), (7) and (8) (excluding bankruptcy proceeding in terms of the Bankruptcy Act), (9) of the ISDA Master Agreement), except for the provision of Section 5(a)(vii) (4) (A) and (B) and (8) if a bankruptcy proceeding in terms of the Bankruptcy Act is instituted against the Counterparty.

Under Section 6(c)(ii) upon the effectiveness of the notice under Section 6(a) designating the Early Termination Date, the obligations of each party under all Derivatives Transactions cease, for all Events described under Section 5(a)(vii) (1), (2), (3), (4) (excluding bankruptcy proceeding in terms of the Bankruptcy Act), (5),

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<sup>11</sup> In our opinion a "bankruptcy proceeding" pursuant to the Croatian Bankruptcy Act would be qualified as Event(s) of Default set out in Section 5(a)(vii) (4) (A) and (B) (and Section 5(a)(vii) (8)) of the ISDA Master Agreement.

(6), (7), (8) (excluding bankruptcy proceeding in terms of the Bankruptcy Act) and (9) of the ISDA Master Agreement).

The provisions of the Master Agreement, in particular the termination provision of Section 6(a), permitting the non-defaulting party to terminate all the Derivatives Transactions upon Events described under Section 5(a)(vii) (1), (2), (3), (4) (excluding bankruptcy proceeding in terms of the Bankruptcy Act), (5), (6), (7), (8) (excluding bankruptcy proceeding in terms of the Bankruptcy Act) (9) of the Master Agreement) of its Counterparty are enforceable under the Croatian laws and in respect of the Counterparty, provided that the Early Termination Date falls before the institution of bankruptcy proceedings.

Therefore, we believe that a Croatian court would give effect to Sections 2(a)(iii) and 6(c) of the ISDA Master Agreement, which make performance of payment and delivery obligations in respect of individual Derivatives Transaction conditional upon the fact that an Early Termination Date has not occurred or been effectively designated.

Termination by notice is recognised by the Croatian Obligation Code as a standard termination mechanism and therefore the parties are free to regulate the conditions of termination if the ISDA Master Agreement is breached by a Defaulting Party (upon the occurrence of an Event of Default).

If, contrary to the Events of Default described under Section 5(a)(vii) (1), (2), (3), (4) (excluding bankruptcy proceeding in terms of the Bankruptcy Act), (5), (6), (7), (8) (excluding bankruptcy proceeding in terms of the Bankruptcy Act) (9) of the Master Agreement) a bankruptcy proceeding (“stečajni postupak”, “stečaj”) in terms of the Bankruptcy Act is instituted against the Croatian party that is subject to the Croatian Bankruptcy Act, being qualified as an Event of Default provided under Section 5(a)(vii) (4) (A) and (B) (and/or Section 5(a)(vii) (8)), it is not clear whether the Croatian court would give effect to the termination by notice provisions of the ISDA Master Agreement (which termination by notice is also supported by Article 8 of the Financial Collateral Law) or it would give effect to Article 111 of the Bankruptcy Act. If a Croatian court gives effect to the Financial Collateral Law, in such case termination by notice would be enforceable pursuant to the provisions of the ISDA Master Agreement even if there is a bankruptcy proceeding instituted against a Croatian party. If, however, Croatian court gives effect to the Bankruptcy Act, termination by notice cannot be enforceable, since Article 111 (4) and (5) provide that upon the institution of a bankruptcy proceeding all transactions subject to the ISDA Master Agreement shall not be performed but rather a close – out net amount shall be calculated on the second business day after bankruptcy proceedings have been instituted. That means that the Early Termination Date shall be designated by virtue of the Bankruptcy Act and not by the Non-Defaulting Party.

#### II.8.2.2 ARTICLE 111 OF THE BANKRUPTCY ACT

The general rule in respect of contracts that have not been performed after the institution of bankruptcy proceeding is provided in Article 110 of the Bankruptcy Act. Pursuant to the mentioned provision, if a contract providing for reciprocal obligations has not or is not fully performed by the debtor and the other party at the time of the

institution of insolvency (bankruptcy) proceedings, the bankruptcy administrator may perform the contract in lieu of the debtor and require performance from the other party. If the bankruptcy administrator refuses to perform, the other party may assert a claim for non-performance only as a creditor in bankruptcy proceedings. If the other party requests the bankruptcy administrator to exercise his right of election, the bankruptcy administrator must promptly declare whether or not he demands performance. If he fails to inform the other party, he may no longer require a performance.

A specific rule related to Derivatives Transactions in bankruptcy is provided in Article 111 of the Bankruptcy Act. Please find the complete text of Article 111 in Appendix B to this Legal Memorandum.

Pursuant to the stated Article 111 of the Bankruptcy Act, under the assumptions that the Bankruptcy Act would apply in case there is a bankruptcy proceeding instituted against a Croatian party, the conditions for the close-out netting in respect of Derivatives Transactions would be the following: 1) that there is a master agreement in force executed between the parties, 2) a market value of Derivatives Transactions and 3) a fixed term of Derivatives Transactions. The conclusion would be that if there is no master agreement in place or when a transaction does not have a market value or when a transaction does not have a fixed term (e.g. like an open repo transaction), we are of the opinion that such transactions shall not be netted in bankruptcy. For such transactions a bankruptcy administrator may choose among such transactions and “cherry-pick” whether to execute such transactions or not. According to the quoted Article 110, a bankruptcy administrator, after the bankruptcy proceeding has commenced, has a right to selectively pick among the different outstanding obligations and choose which one to terminate and which one to continue, except in case of Article 111 if such Derivatives Transactions satisfy the requirements given in Article 111.

Furthermore, Article 111 (4) and (5) of the Bankruptcy Act also provide that **transactions (Derivatives Transactions) shall be terminated<sup>12</sup> on the second business day from the day the bankruptcy proceeding has commenced**, whereas the Financial Collateral Law provides a different legal solution as analysed further in this Legal Memorandum.

The issue that is currently under consideration by ISDA in respect of bankruptcy of Croatian parties that are subject to the Bankruptcy Act is a discrepancy between Article 111 (4) of the Bankruptcy Act and Article 8 of the Financial Collateral Law.

#### II.8.2.3 ARTICLE 8 OF THE FINANCIAL COLLATERAL LAW

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<sup>12</sup> It is not consistently regulated by the Bankruptcy Act whether all of the transactions and the ISDA Master Agreement shall be terminated ipso jure on the institution of the bankruptcy proceeding or on the second business day after the bankruptcy proceeding has been instituted, however, there is no doubt that the calculation of the close-out net amount shall be performed on the second (working) day after the bankruptcy proceeding has been instituted. In our opinion it would make more sense that the close-out net amount (including the replacement value of all Derivatives Transactions) is calculated on all transactions that are terminated. All Derivatives Transactions (except open transactions and transactions with no market value) shall be terminated either on the institution of bankruptcy or 2 days thereafter.

Pursuant to Article 8 (1) of the Financial Collateral Law a settlement of obligations arising out of the financial collateral agreements, including **an early termination of such obligations respectively netting shall be performed according to provisions of such agreement despite the fact that either a** bankruptcy proceeding or a liquidation proceeding or reorganisation measures are imposed against either the collateral provider or the collateral taker.

We can conclude that for all Croatian entities that are subject to the Bankruptcy Act it is not clear whether Article 111 of the Bankruptcy Act or Article 8 of the Financial Collateral Law shall apply. Either the Derivatives Transactions shall be terminated upon an institution of bankruptcy proceeding and the close – out net amount shall be calculated as of the second business day upon institution of bankruptcy or all Derivatives Transactions shall be terminated pursuant to the terms provided in the ISDA Master Agreement and therefore an Early Termination Date shall be designated accordingly.

For the avoidance of the existing legal discrepancy it would be advised to elect Automatic Early Termination provision if a bankruptcy proceeding (as defined by the Croatian Bankruptcy Act) is instituted against a Croatian party. For all other Events of Default described under Section 5(a)(vii) (1), (2), (3), (4) (excluding bankruptcy proceeding in terms of the Bankruptcy Act), (5), (6), (7) and (8) (excluding bankruptcy proceeding in terms of the Bankruptcy Act), (9) of the Master Agreement Automatic Early Termination is optional, since although all such events may have as their final consequence an institution of bankruptcy proceeding, an Early Termination Date can still be designated to fall before institution of bankruptcy proceeding.

Please note that there is no court practice of Croatian courts related to the enforceability of Automatic Early Termination.

#### II.8.2.4 AUTOMATIC EARLY TERMINATION

Where the parties have selected Automatic Early Termination, Section 6(a) provides that an Early Termination Date will be deemed to have occurred upon the occurrence of certain Events of Default specified in Section 5(a)(vii) in respect of a party. Section 6(c)(ii) provides that upon the deemed occurrence of an Early Termination Date, the obligations of each of the parties under all Transactions cease.

We believe that the Automatic Early Termination if elected to apply in relation to the Croatian party would be enforceable under Croatian law as provided in the ISDA Master Agreement. This would be particularly important upon the institution of bankruptcy proceeding in terms of the Bankruptcy Act (Section 5(a)(vii) (4) and (8)) which is recommended in order to avoid the above-described legal discrepancy between Article 8 of the Financial Collateral Law and Article 111 of the Bankruptcy Act. Therefore, where the parties have elected Automatic Early Termination to apply in respect of bankruptcy (as defined by the Bankruptcy Act), an Early Termination Date will be deemed to have occurred before bankruptcy proceeding is instituted, then the provision of the ISDA Master Agreement automatically terminating all Derivative Transactions are enforceable under Croatian law. Section 6(c) (ii) provides that upon the deemed occurrence of an Early Termination Date, the obligations of each of the

parties under all Derivatives Transactions cease. In our opinion in case of a bankruptcy proceeding this would be at the time immediately preceding the presentation of petition for commencing the bankruptcy proceeding.

### III. 8.3 DETERMINATION OF A SINGLE LUMP SUM TERMINATION AMOUNT

We are of the opinion that the provisions of the ISDA Master Agreement providing for the netting of termination values in determining a single lump-sum termination amount upon the insolvency of a Croatian party are generally enforceable under Croatian law.

However, we still need to emphasise that if a bankruptcy proceeding (as defined by the Bankruptcy Act) is instituted, we have certain remarks on the Article 111 of the Bankruptcy Act based on the above described legal discrepancy with/as compared to Article 8 of the Financial Collateral Law.

If a Croatian court interprets that the Bankruptcy Act shall prevail, in such case the determination of a single lump-sum should be made on the second working day after the bankruptcy proceeding has commenced (it is not clear whether the costs related to the early termination shall be netted thereto as well), and not pursuant to the Section 6(a) of the ISDA Master Agreement. In such case the transactions with no market value and no fixed term like open repo transactions might not be calculated in the single lump-sum termination amount. If Automatic Early Termination applies, all transaction will be terminated on the basis of the terms of the ISDA Master Agreement.

If the Financial Collateral Law prevails, in such case the netting of termination values in determining a single lump-sum termination amount upon bankruptcy shall be enforceable according to the terms provided in the ISDA Master Agreement.

Both laws are dealing with a single lump sum, however, the Bankruptcy Act requests that such lump sum should be calculated on the basis of the values as of the second business day after the bankruptcy proceeding has commenced (this is not a solution given under Article 6 (a) of the ISDA Master Agreement).

### II.8.4 TERMINATION CURRENCY

Assuming the parties have entered into an ISDA Master Agreement, one of the parties is insolvent and the parties have selected a Termination Currency other than the currency of Croatia, the provisions of the ISDA Master Agreement requiring payment of the net termination amount in that termination currency would be enforceable under Croatian law.

However, if bankruptcy proceeding (“stečajni postupak”) is instituted against a Croatian party, all foreign currency claims have to be converted into the local currency which is Croatian “Kuna”. According to Article 77, second sentence of the Croatian Bankruptcy Act: “Foreign currency claims or claims related to the calculation units must be expressed in the currency of the Republic of Croatia,

whereby when a foreign currency is converted into a Croatian currency, such exchange rate shall apply that is relevant (official) at the time of and on the place where bankruptcy proceedings have commenced.” We believe that in this case conversion to Croatian Kuna in bankruptcy is compulsory.

### **III. FINANCIAL COLLATERAL SUMMARY**

The Financial Collateral Law, as already mentioned, is based on the Directive 2002/47/EC of the European Parliament and the Council of 6 June 2002 on financial collateral arrangements (further referred to as: the “Financial Collateral Directive”). The Republic of Croatia has not implemented the latest amendments to the Financial Collateral Directive.

The Financial Collateral Law regulates the “financial collateral” providing the basic difference between such collateral and other types of collateral in the Croatian legal system. For financial collaterals regulated by the Financial Collateral Law there are no formal requirements prescribed as such formalities that are required for classic types of collateral in the Republic of Croatia such as pledge, mortgage etc.

The Financial Collateral Law recognises two legal types of collateralisation: the transfer of title and the security interest etc. Please note that Croatian Financial Collateral Law translates “security interest” into “special type of pledge” in order to strictly divide this concept from the concept of classic pledge already existing in Croatian legal system.

As collateral instruments, the Financial Collateral Law recognises:

1. financial instruments and
2. cash (money).

In respect of the Financial Collateral Law, “financial instruments” means shares in companies and other securities equivalent to shares in companies and bonds and other forms of debt instruments if these are negotiable on the capital market, investment funds units, money market instruments and any other securities which are normally dealt in and which give the right to acquire any such shares, bonds or other securities or which give rights to monetary claims and derivatives, and all rights related to such financial instruments except promissory notes and checks.

Furthermore, “cash” means money credited to an account in any currency or deposit in any currency except banknotes (notes and coins).

Please note that provisions of the Financial Collateral Law shall essentially apply to all types of entities (including corporates and natural persons) if they are entering into a financial collateral agreement with any of (mostly financial) institutions listed in the Financial Collateral Law (such as: public entities of the Member States authorised to manage public debt or run business accounts, various central banks (including supra national banks and institutions – World Bank, IMF, EIB etc.), financial institutions like credit institutions, investment houses, insurance companies, undertakings for mutual investments and central counterparties, clearing agents and clearing

organisations; in Croatia: Croatian National Bank, Croatian Bank for Reconstruction and Development, banks, saving houses, insurance companies, pension and investment funds, Central Clearing Depository Agency, Croatian Health Insurance Institution; Croatian Pension Institution and other entities authorised to provide banking and other financial services.)

In our opinion the essential point of the Financial Collateral Law is Article 8 providing that in case of bankruptcy either a collateral taker or a collateral provider, the terms of the financial collateral agreement, including netting, shall be considered as relevant – e.g. the fulfilment of obligations arising out of the financial collateral agreement (including netting) shall be made according to the terms provided in agreement, notwithstanding the fact that the bankruptcy proceeding has already commenced.

#### **IV. PENDING LEGAL DEVELOPMENTS**

As already stated in this Legal Memorandum, in respect of the enforceability of the “close-out netting” provisions of the ISDA Master Agreement, there is currently no court practice in Croatia. Therefore, we are of the opinion that it would be critical that the Croatian Parliament passes certain amendments to the laws that are currently in force that would primarily resolve the legal discrepancy between Article 111 of the Croatian Bankruptcy Act and Article 8 of the Croatian Financial Collateral Law.

The former Minister of Finance commenced the harmonisation of the Financial Collateral Law with the Directive 2009/44/EC amending the Settlement Finality Directive and the Financial Collateral Arrangements, however, this process remained uncompleted. Therefore, we estimate that the new Minister of Finance shall complete this task, however, the precise timing for finalisation of the draft amendments to the Financial Collateral Law cannot be predicted at this moment.

It has to be noted that besides the legal discrepancy mentioned in this Legal Memorandum, a “fine tuning” of other financial and capital markets related laws would be recommended in order to support a smooth and easy enforceability of Derivatives Transactions in Croatia, which was not possible to elaborate in this document.

Looking from the legal practitioner’s perspective, it should be noted that about a month ago there was a default of a small local bank (“Credo banka d.d.”) that had entered into numerous domestic repurchase master agreements and related repurchase transactions with several local banks. The governing law to such agreements/transactions was Croatian law and some of those master agreements contained a close-out netting clause. We recommend to keep an eye on the future development of this bankruptcy proceeding since it may have influence on the practice of Croatian courts and bankruptcy administrators regarding the relevant close-out netting issues in the nearest future.

In respect of the draft of the Securitisation Act that was prepared four years ago, it seems there is no progress of any kind due to the financial crisis. We discovered that the draft had been left in the draw of someone at the Ministry of Finance during the



term of the former Government. We have no other information related thereto and it is unknown to the public when and if this draft shall be on the Government's agenda again.

Finally, it can be concluded that if Croatian citizens vote for the EU membership on January 22<sup>nd</sup>, 2012, it is highly likely that the "passporting rules" recognised by the EU shall come into force on July 1<sup>st</sup>, 2013. Current estimations show that there shall be 55% votes for joining the EU.

\* \* \*

If you need any further clarification, please do not hesitate to contact us.

Yours sincerely,

Marijana Jelić  
Attorney – at – Law

## **APPENDIX A**

### **CERTAIN TRANSACTIONS UNDER the ISDA Master Agreements**

#### **Transaction Types**

**Basis Swap.** A transaction in which one party pays periodic amounts of a given currency based on a floating rate and the other party pays periodic amounts of the same currency based on another floating rate, with both rates reset periodically; all calculations are based on a notional amount of the given currency.

**Bond Forward.** A transaction in which one party agrees to pay an agreed price for a specified amount of a bond of an issuer or a basket of bonds of several issuers at a future date and the other party agrees to pay a price for the same amount of the same bond to be set on a specified date in the future. The payment calculation is based on the amount of the bond and can be physically-settled (where delivery occurs in exchange for payment) or cash-settled (where settlement occurs based on the difference between the agreed forward price and the prevailing market price at the time of settlement).

**Bond Option.** A transaction in which one party grants to the other party (in consideration for a premium payment) the right, but not the obligation, to purchase (in the case of a call) or sell (in the case of a put) a specified amount of a bond of an issuer, such as Kingdom of Sweden or Unilever N.V., at a specified strike price. The bond option can be settled by physical delivery of the bonds in exchange for the strike price or may be cash settled based on the difference between the market price of the bonds on the exercise date and the strike price.

**Bullion Option.** A transaction in which one party grants to the other party (in consideration for a premium payment) the right, but not the obligation, to purchase (in the case of a call) or sell (in the case of a put) a specified number of Ounces of Bullion at a specified strike price. The option may be settled by physical delivery of Bullion in exchange for the strike price or may be cash settled based on the difference between the market price of Bullion on the exercise date and the strike price.

**Bullion Swap.** A transaction in which one party pays periodic amounts of a given currency based on a fixed price or a fixed rate and the other party pays periodic amounts of the same currency or a different currency calculated by reference to a Bullion reference price (for example, Gold-COMEX on the COMEX Division of the New York Mercantile Exchange) or another method specified by the parties. Bullion swaps include cap, collar or floor transactions in respect of Bullion.

**Bullion Trade.** A transaction in which one party agrees to buy from or sell to the other party a specified number of Ounces of Bullion at a specified price for settlement either on a “spot” or two-day basis or on a specified future date. A Bullion Trade may be settled by physical delivery of Bullion in exchange for a specified price or may be cash settled based on the difference between the market price of Bullion on the settlement date and the specified price. For purposes of Bullion Trades, Bullion Options and Bullion Swaps, “Bullion” means gold, silver, platinum or palladium and “Ounce” means, in the case of gold, a fine troy ounce, and in the case of silver, platinum and palladium, a troy ounce (or in the case of reference prices not expressed in Ounces, the relevant Units of gold, silver, platinum or palladium).

**Buy/Sell-Back Transaction.** A transaction in which one party purchases a security (in consideration for a cash payment) and agrees to sell back that security (or in some cases an

equivalent security) to the other party (in consideration for the original cash payment plus a premium).

Cap Transaction. A transaction in which one party pays a single or periodic fixed amount and the other party pays periodic amounts of the same currency based on the excess, if any, of a specified floating rate (in the case of an interest rate cap), rate or index (in the case of an economic statistic cap) or commodity price (in the case of a commodity cap) in each case that is reset periodically over a specified per annum rate (in the case of an interest rate cap), rate or index (in the case of an economic statistic cap) or commodity price (in the case of a commodity cap).

Collar Transaction. A collar is a combination of a cap and a floor where one party is the floating rate, floating index or floating commodity price payer on the cap and the other party is the floating rate, floating index or floating commodity price payer on the floor.

Commodity Forward. A transaction in which one party agrees to purchase a specified quantity of a commodity at a future date at an agreed price and the other party agrees to pay a price for the same quantity to be set on a specified date in the future. The payment calculation is based on the quantity of the commodity and is settled based, among other things, on the difference between the agreed forward price and the prevailing market price at the time of settlement.

Commodity Option. A transaction in which one party grants to the other party (in consideration for a premium payment) the right, but not the obligation, to purchase (in the case of a call) or sell (in the case of a put) a specified quantity of a commodity at a specified strike price. The option can be settled either by physically delivering the quantity of the commodity in exchange for the strike price or by cash settling the option, in which case the seller of the option would pay to the buyer the difference between the market price of that quantity of the commodity on the exercise date and the strike price.

Commodity Swap. A transaction in which one party pays periodic amounts of a given currency based on a fixed price and the other party pays periodic amounts of the same currency based on the price of a commodity, such as natural gas or gold, or a futures contract on a commodity (e.g., West Texas Intermediate Light Sweet Crude Oil on the New York Mercantile Exchange); all calculations are based on a notional quantity of the commodity.

Contingent Credit Default Swap. A Credit Default Swap Transaction under which the calculation amounts applicable to one or both parties may vary over time by reference to the mark-to-market value of a hypothetical swap transaction.

Credit Default Swap Option. A transaction in which one party grants to the other party (in consideration for a premium payment) the right, but not the obligation, to enter into a Credit Default Swap.

Credit Default Swap. A transaction in which one party pays either a single fixed amount or periodic fixed amounts or floating amounts determined by reference to a specified notional amount, and the other party (the credit protection seller) pays either a fixed amount or an amount determined by reference to the value of one or more loans, debt securities or other financial instruments (each a "Reference Obligation") issued, guaranteed or otherwise entered into by a third party (the "Reference Entity") upon the occurrence of one or more specified credit events with respect to the Reference Entity (for example, bankruptcy or payment default). The amount payable by the credit protection seller is typically determined based upon the market value of one or more debt securities or other debt instruments issued, guaranteed or otherwise entered into by the Reference Entity. A Credit Default Swap may also be physically settled by payment of a specified fixed amount by one party against delivery of specified obligations ("Deliverable Obligations") by the other party. A Credit

Default Swap may also refer to a “basket” (typically ten or less) or a “portfolio” (eleven or more) of Reference Entities or may be an index transaction consisting of a series of component Credit Default Swaps.

Credit Derivative Transaction on Asset-Backed Securities. A Credit Default Swap for which the Reference Obligation is a cash or synthetic asset-backed security. Such a transaction may, but need not necessarily, include “pay as you go” settlements, meaning that the credit protection seller makes payments relating to interest shortfalls, principal shortfalls and write-downs arising on the Reference Obligation and the credit protection buyer makes additional fixed payments of reimbursements of such shortfalls or write-downs.

Credit Spread Transaction. A transaction involving either a forward or an option where the value of the transaction is calculated based on the credit spread implicit in the price of the underlying instrument.

Cross Currency Rate Swap. A transaction in which one party pays periodic amounts in one currency based on a specified fixed rate (or a floating rate that is reset periodically) and the other party pays periodic amounts in another currency based on a floating rate that is reset periodically. All calculations are determined on predetermined notional amounts of the two currencies; often such swaps will involve initial and or final exchanges of amounts corresponding to the notional amounts.

Currency Option. A transaction in which one party grants to the other party (in consideration for a premium payment) the right, but not the obligation, to purchase (in the case of a call) or sell (in the case of a put) a specified amount of a given currency at a specified strike price.

Currency Swap. A transaction in which one party pays fixed periodic amounts of one currency and the other party pays fixed periodic amounts of another currency. Payments are calculated on a notional amount. Such swaps may involve initial and or final payments that correspond to the notional amount.

Economic Statistic Transaction. A transaction in which one party pays an amount or periodic amounts of a given currency by reference to interest rates or other factors and the other party pays or may pay an amount or periodic amounts of a currency based on a specified rate or index pertaining to statistical data on economic conditions, which may include economic growth, retail sales, inflation, consumer prices, consumer sentiment, unemployment and housing.

Emissions Allowance Transaction. A transaction in which one party agrees to buy from or sell to the other party a specified quantity of emissions allowances or reductions at a specified price for settlement either on a “spot” basis or on a specified future date. An Emissions Allowance Transaction may also constitute a swap of emissions allowances or reductions or an option whereby one party grants to the other party (in consideration for a premium payment) the right, but not the obligation, to receive a payment equal to the amount by which the specified quantity of emissions allowances or reductions exceeds or is less than a specified strike. An Emissions Allowance Transaction may be physically settled by delivery of emissions allowances or reductions in exchange for a specified price, differing vintage years or differing emissions products or may be cash settled based on the difference between the market price of emissions allowances or reductions on the settlement date and the specified price.

Equity Forward. A transaction in which one party agrees to pay an agreed price for a specified quantity of shares of an issuer, a basket of shares of several issuers or an equity index at a future date and the other party agrees to pay a price for the same quantity and shares to be set on a specified date in the future. The payment calculation is based on the number of shares and can be physically-settled (where delivery occurs in exchange for payment) or cash-settled

(where settlement occurs based on the difference between the agreed forward price and the prevailing market price at the time of settlement).

Equity Index Option. A transaction in which one party grants to the other party (in consideration for a premium payment) the right, but not the obligation, to receive a payment equal to the amount by which an equity index either exceeds (in the case of a call) or is less than (in the case of a put) a specified strike price.

Equity Option. A transaction in which one party grants to the other party (in consideration for a premium payment) the right, but not the obligation, to purchase (in the case of a call) or sell (in the case of a put) a specified number of shares of an issuer or a basket of shares of several issuers at a specified strike price. The share option may be settled by physical delivery of the shares in exchange for the strike price or may be cash settled based on the difference between the market price of the shares on the exercise date and the strike price.

Equity Swap. A transaction in which one party pays periodic amounts of a given currency based on a fixed price or a fixed or floating rate and the other party pays periodic amounts of the same currency or a different currency based on the performance of a share of an issuer, a basket of shares of several issuers or an equity index, such as the Standard and Poor's 500 Index.

Floor Transaction. A transaction in which one party pays a single or periodic amount and the other party pays periodic amounts of the same currency based on the excess, if any, of a specified per annum rate (in the case of an interest rate floor), rate or index level (in the case of an economic statistic floor) or commodity price (in the case of a commodity floor) over a specified floating rate (in the case of an interest rate floor), rate or index level (in the case of an economic statistic floor) or commodity price (in the case of a commodity floor).

Foreign Exchange Transaction. A deliverable or non-deliverable transaction providing for the purchase of one currency with another currency providing for settlement either on a "spot" or two-day basis or a specified future date.

Forward Rate Transaction. A transaction in which one party agrees to pay a fixed rate for a defined period and the other party agrees to pay a rate to be set on a specified date in the future. The payment calculation is based on a notional amount and is settled based, among other things, on the difference between the agreed forward rate and the prevailing market rate at the time of settlement.

Freight Transaction. A transaction in which one party pays an amount or periodic amounts of a given currency based on a fixed price and the other party pays an amount or periodic amounts of the same currency based on the price of chartering a ship to transport wet or dry freight from one port to another; all calculations are based either on a notional quantity of freight or, in the case of time charter transactions, on a notional number of days.

Fund Option Transaction: A transaction in which one party grants to the other party (for an agreed payment or other consideration) the right, but not the obligation, to receive a payment

based on the redemption value of a specified amount of an interest issued to or held by an investor in a fund, pooled investment vehicle or any other interest identified as such in the relevant Confirmation (a “Fund Interest”), whether i) a single class of Fund Interest of a Single Reference Fund or ii) a basket of Fund Interests in relation to a specified strike price. The Fund Option Transactions will generally be cash settled (where settlement occurs based on the excess of such redemption value over such specified strike price (in the case of a call) or the excess of such specified strike price over such redemption value (in the case of a put) as measured on the valuation date or dates relating to the exercise date).

Fund Forward Transaction: A transaction in which one party agrees to pay an agreed price for the redemption value of a specified amount of i) a single class of Fund Interest of a Single Reference Fund or ii) a basket of Fund Interests at a future date and the other party agrees to pay a price for the redemption value of the same amount of the same Fund Interests to be set on a specified date in the future. The payment calculation is based on the amount of the redemption value relating to such Fund Interest and generally cash-settled (where settlement occurs based on the difference between the agreed forward price and the redemption value measured as of the applicable valuation date or dates).

Fund Swap Transaction: A transaction a transaction in which one party pays periodic amounts of a given currency based on a fixed price or a fixed rate and the other party pays periodic amounts of the same currency based on the redemption value of i) a single class of Fund Interest of a Single Reference Fund or ii) a basket of Fund Interests.

Interest Rate Option. A transaction in which one party grants to the other party (in consideration for a premium payment) the right, but not the obligation, to receive a payment equal to the amount by which an interest rate either exceeds (in the case of a call option) or is less than (in the case of a put option) a specified strike rate.

Interest Rate Swap. A transaction in which one party pays periodic amounts of a given currency based on a specified fixed rate and the other party pays periodic amounts of the same currency based on a specified floating rate that is reset periodically, such as the London inter-bank offered rate; all calculations are based on a notional amount of the given currency.

Longevity/Mortality Transaction. (a) A transaction employing a derivative instrument, such as a forward, a swap or an option, that is valued according to expected variation in a reference index of observed demographic trends, as exhibited by a specified population, relating to aging, morbidity, and mortality/longevity, or (b) A transaction that references the payment profile underlying a specific portfolio of longevity- or mortality- contingent obligations, e.g. a pool of pension liabilities or life insurance policies (either the actual claims payments or a synthetic basket referencing the profile of claims payments).

Physical Commodity Transaction. A transaction which provides for the purchase of an amount of a commodity, such as oil including oil products, coal, electricity or gas, at a fixed or floating price for actual delivery on one or more dates.

Property Index Derivative Transaction. A transaction, often structured in the form of a forward, option or total return swap, between two parties in which the underlying value of the transaction is based on a rate or index based on residential or commercial property prices for a specified local, regional or national area.

Repurchase Transaction. A transaction in which one party agrees to sell securities to the other party and such party has the right to repurchase those securities (or in some cases equivalent securities) from such other party at a future date.

Securities Lending Transaction. A transaction in which one party transfers securities to a party acting as the borrower in exchange for a payment or a series of payments from the borrower and the borrower's obligation to replace the securities at a defined date with identical securities.

Swap Deliverable Contingent Credit Default Swap. A Contingent Credit Default Swap under which one of the Deliverable Obligations is a claim against the Reference Entity under an ISDA Master Agreement with respect to which an Early Termination Date (as defined therein) has occurred.

Swap Option. A transaction in which one party grants to the other party the right (in consideration for a premium payment), but not the obligation, to enter into a swap with certain specified terms. In some cases the swap option may be settled with a cash payment equal to the market value of the underlying swap at the time of the exercise.

Total Return Swap. A transaction in which one party pays either a single amount or periodic amounts based on the total return on one or more loans, debt securities or other financial instruments (each a "Reference Obligation") issued, guaranteed or otherwise entered into by a third party (the "Reference Entity"), calculated by reference to interest, dividend and fee payments and any appreciation in the market value of each Reference Obligation, and the other party pays either a single amount or periodic amounts determined by reference to a specified notional amount and any depreciation in the market value of each Reference Obligation.

A total return swap may (but need not) provide for acceleration of its termination date upon the occurrence of one or more specified events with respect to a Reference Entity or a Reference Obligation with a termination payment made by one party to the other calculated by reference to the value of the Reference Obligation.

Weather Index Transaction. A transaction, structured in the form of a swap, cap, collar, floor, option or some combination thereof, between two parties in which the underlying value of the transaction is based on a rate or index pertaining to weather conditions, which may include measurements of heating, cooling, precipitation and wind.

## APPENDIX B

Article 111 of the Bankruptcy Act (Official Gazette No. 44/96 (Banking Act, Official Gazette No. 161/98), 29/99, 129/00, 123/03, Decisions on the Amendments to the Bankruptcy Act Official Gazette No. 197/03 and 187/06, 82/06, 116/10):

“Fixed Transactions. Financial Transactions with Fixed Term.

- (1) If it was stipulated that the supply of goods that have a market or an exchange price is to be performed at a fixed time or within a fixed period of time, and if such time or the expiration of such period occurs after the institution of bankruptcy proceeding, then in lieu of performance only a claim for non-performance of fixed transactions may be asserted by the other counterparty.
- (2) If a term or a deadline was stipulated for financial services that have a market or an exchange price, and such term or deadline occurs after the institution of bankruptcy proceeding, then in lieu of performance only a claim for non-performance may be asserted by the other counterparty.
- (3) The term “financial services” in respect of sub-paragraph 2 of this Article shall particularly mean:
  1. the delivery of precious metals,
  2. the delivery of securities or similar rights, unless it is intended to acquire an interest in another company for purposes of creating a permanent connection to such company;
  3. monetary payments performed in a foreign currency or any currency unit;
  4. monetary payments the amount of which is determined directly or indirectly, by the currency rate of a foreign currency or a currency unit or the interest rate applied to a claim or the price of other goods or services;
  5. options and other rights for delivery or monetary payments pursuant to 1 to 4 of this sub - paragraph.
- (4) If financial services are combined in a master agreement for which it has been agreed that it may be terminated for breach of contract only by consent<sup>13</sup>, then all such individual transactions shall constitute a single agreement providing for reciprocal obligations within the meaning of this Article and Article 110 of this Act.

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<sup>13</sup> Here we need to point out that it is highly likely that one grammatical error occurred at the time Bankruptcy Act was published in the Official Gazette. The Bankruptcy Act has been mostly „copied“ from German Insolvency Code as of October 6th, 1994. The provision of the German original text that was literally copied/enacted was: *“If individual contracts regarding financial transaction are combined in a master agreement for which it has been agreed it may be terminated for breach of contract **in its entirety**, then all such individual contracts shall constitute a single contract providing for reciprocal obligation with the meaning of §§ 103, 104.”* The Croatian „translation“ (actually, enactment of the same text) contains an error – the words „in its entirety“ were translated into „by consent“, what does not make any sense in practice. We believe the intention of the Croatian Parliament was to follow the original German text.



- (5) The claim for non-performance stated under previous sub - paragraphs of this Article shall be determined by the difference between the agreed price and that market or exchange price which on the second business day after the institution of the bankruptcy proceedings prevails at the place of performance for contract entered into with the stipulated time. The other party may assert such claim only as a creditor in bankruptcy proceedings.”