



Safe,
Efficient
Markets

Derivatives in Emerging Markets

**ENHANCING FINANCIAL INTEGRITY:
THE GENEVA CONVENTION AND THE UNIDROIT PRINCIPLES ON
CLOSE-OUT NETTING UNDER
NATIONAL LAW**

***UNIDROIT COMMITTEE ON EMERGING MARKETS ISSUES,
FOLLOW-UP AND IMPLEMENTATION
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The Need for Law Reform

- The development and use of derivatives products has become ubiquitous spreading around the world
- Effective risk management requires legal certainty. In the ISDA context this means:
 - Enforceability of derivatives contracts
 - Clarity of insolvency law and enforceability of netting provisions
 - Clarity regarding the treatment of collateral

The Need for Law Reform

- Significant variation in national insolvency and property laws around the world affects the enforceability of derivatives transactions under industry standard netting and collateral agreements (eg, ISDA Master Agreement for global cross-border transactions, local master agreements)
- ISDA's law reform efforts aim at addressing these concerns, working with multinational organizations as well as national authorities

Financial Market Law Reform: Key Questions

- Knowing where you stand: the practical value of increasing legal certainty
 - An abstract goal, but with concrete results: increased market confidence, more liquidity, greater financial stability
- Key questions:
 - Will my agreement be respected and enforced by a court or arbitration tribunal?
 - Will foreign law governed contracts and foreign based counterparties be treated equally?
 - Will it be enforced as written, both before and after my counterparty's insolvency?
 - How can I protect against the risk of my counterparty's insolvency?
 - Early termination and close-out netting under a master agreement
 - Set-off rights
 - Financial collateral arrangements and other forms of security
 - Guarantees, letters of credit, insurance, credit derivatives

Law Reform Efforts in Emerging Markets

- Crucial role of intergovernmental organizations in enhancing legal certainty by promoting harmonization of capital markets legislation
- Since 1987 ISDA has been developing standard contracts, recommendations and model laws on netting and for collateral transactions
 - ISDA netting legislation initiatives in EMEA, LatAm, Asia-Pac
 - ISDA Model Netting Act and Memorandum on Implementation of Netting Legislation (latest version published October 2007)
 - ISDA Master Agreements and supplemental standard documentation (collateral)
 - Positive industry legal opinions to obtain regulatory capital approval (Basel Capital Accords)

ISDA Netting Opinions

- | | | |
|---|-----------------|----------------------|
| 1. Anguilla | 20. England | 40. New Zealand |
| 2. Australia | 21. Finland | 41. Norway |
| 3. Austria | 22. France | 42. Peru |
| 4. Bahamas | 23. Germany | 43. Philippines |
| 5. Barbados | 24. Greece | 44. Poland |
| 6. Belgium | 25. Hong Kong | 45. Portugal |
| 7. Bermuda | 26. Hungary | 46. Russia (pending) |
| 8. Brazil | 27. Iceland | 47. Scotland |
| 9. B.V.I. | 28. India | 48. Singapore |
| 10. Canada | 29. Indonesia | 49. Slovakia |
| 11. Cayman Islands | 30. Ireland | 50. Slovenia |
| 12. Channel Islands - Guernsey | 31. Israel | 51. South Africa |
| 13. Channel Islands - Jersey | 32. Italy | 52. South Korea |
| 14. Chile | 33. Japan | 53. Spain |
| 15. Colombia | 34. Luxembourg | 54. Sweden |
| 16. Cuacao/Aruba / St Maarten
(ex-NL Antilles) | 35. Malays | 55. Switzerland |
| 17. Cyprus | 36. Malta | 56. Taiwan |
| 18. Czech Republic | 37. Mauritius | 57. Thailand |
| 19. Denmark | 38. Mexico | 58. Turkey |
| | 39. Netherlands | 59. United States |

ISDA Collateral Opinions

1. Australia
2. Austria
3. Bahamas
4. Barbados
5. Belgium
6. Bermuda
7. Brazil
8. B.V.I.
9. Canada (Federal, Alberta, Ontario & Quebec)
10. Cayman Islands
11. Channel Islands - Guernsey
12. Channel Islands - Jersey
13. Chile
14. Cyprus
15. Czech Republic
16. Denmark
17. England
18. Finland
19. France
20. Germany
21. Greece
22. Hong Kong
23. Hungary
24. Iceland
25. India
26. Indonesia
27. Ireland
28. Israel
29. Italy
30. Japan
31. Luxembourg
32. Malaysia
33. Mexico
34. Netherlands
35. New Zealand
36. Norway
37. Philippines
38. Poland
39. Portugal
40. Scotland
41. Singapore
42. South Africa
43. South Korea
44. Spain
45. Sweden
46. Switzerland
47. Taiwan
48. Thailand
49. Turkey
50. United States

Selected Int'l Legal Instruments

- UNIDROIT Global Netting Principles
- Geneva Securities Convention
- UNCITRAL Legislative Guide on Secured Transactions
- UNCITRAL Legislative Guide on Insolvency
- Hague Securities Convention
- Hague Choice of Court Convention
- New York Convention (financial disputes: 2013 ISDA Arbitration Guide)
- Vienna Sales Convention/CISG (commodities)
- UN Convention on the Assignment of Receivables in International Trade
- *FSB Key Attributes of Effective Resolution Regimes for Financial Institutions*
- EU Directive on Financial Collateral Arrangements + Amending Directive
- EU Directives on Winding-up of Banks and Insurance Undertakings
- EU Insolvency Regulation
- EU Regulation (Rome I) on the Law Applicable to Contractual Obligations
- EU Regulation (Brussels I) on the Recognition and Enforcement of Judgments in Civil and Commercial Matters
- Other law reform initiatives affecting international finance (e.g. proposals for an EU instrument on netting)

Geneva Securities Convention

- UNIDROIT Convention on Harmonised Substantive Rules Regarding Intermediated Securities
- Functional approach of the draft Convention and the aim to converge on clear and commercially sensible rules
- Why of relevance to derivatives? Impact on:
 - hedging
 - physical settlement of derivatives relating to securities
 - financial collateral arrangements
- Article on set-off by account holder of intermediated securities against debt owed to issuer
- Chapter V: optional chapter on collateral arrangements involving intermediated securities

Collateral arrangements (Ch.V GSC)

Type of financial transactions:

- Derivatives
 - Cleared derivatives – clearing house margin
 - Non-cleared derivatives
 - ISDA Credit Support Annexes, collateral annexes to national master agreements
- Securities sale and repurchase (“repo”) agreements
- Securities lending agreements
- Margin lending and prime brokerage
- Structured finance

Collateral arrangements (Ch.V GSC)

Questions regarding scope

- Types of counterparties
- Relevant financial obligations
- Financial collateral
- Safe harbour provisions from insolvency rules (impact and policy justification)

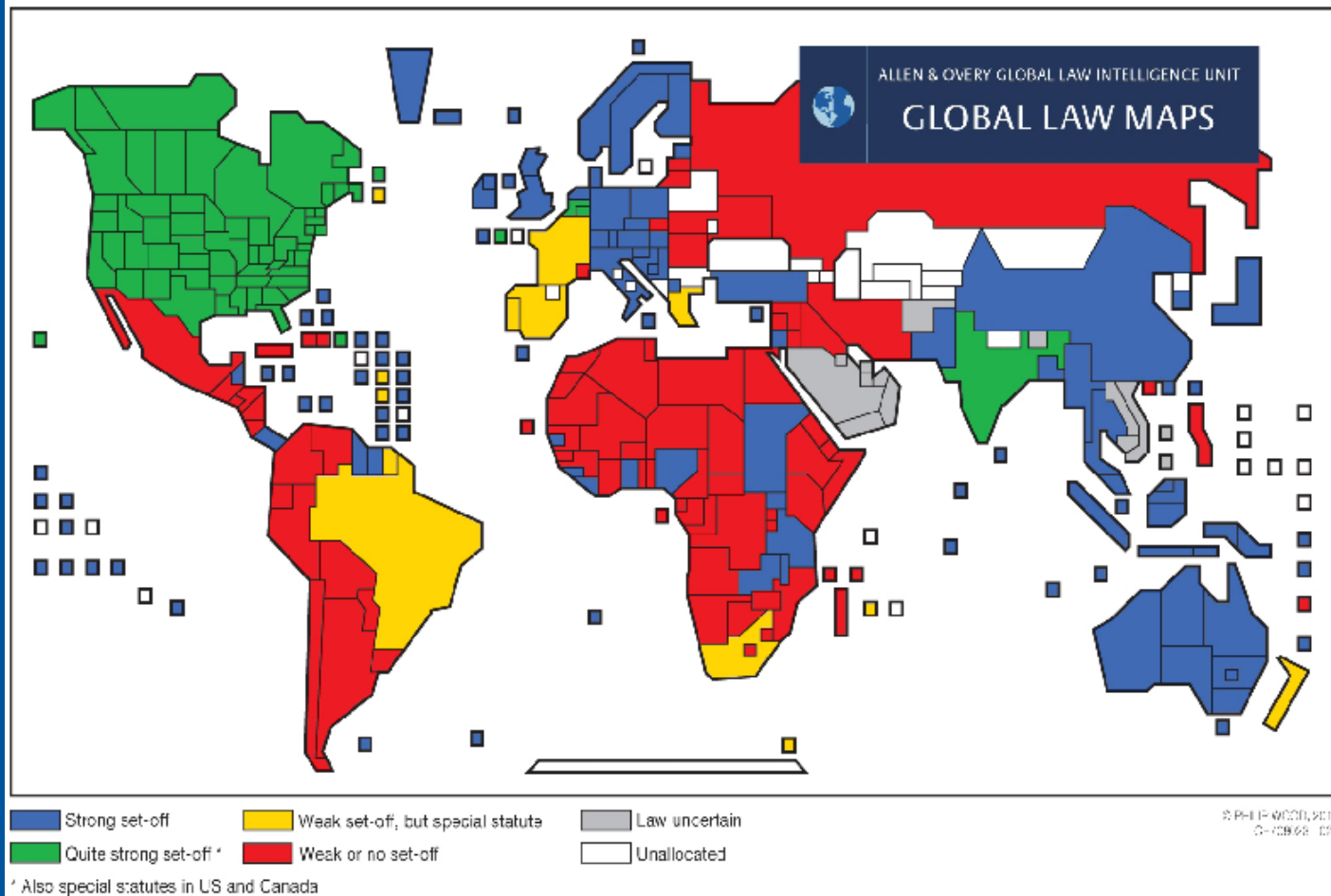
Types of collateral agreements

- Security collateral agreement
- Title transfer collateral agreement
- Including close-out netting provision

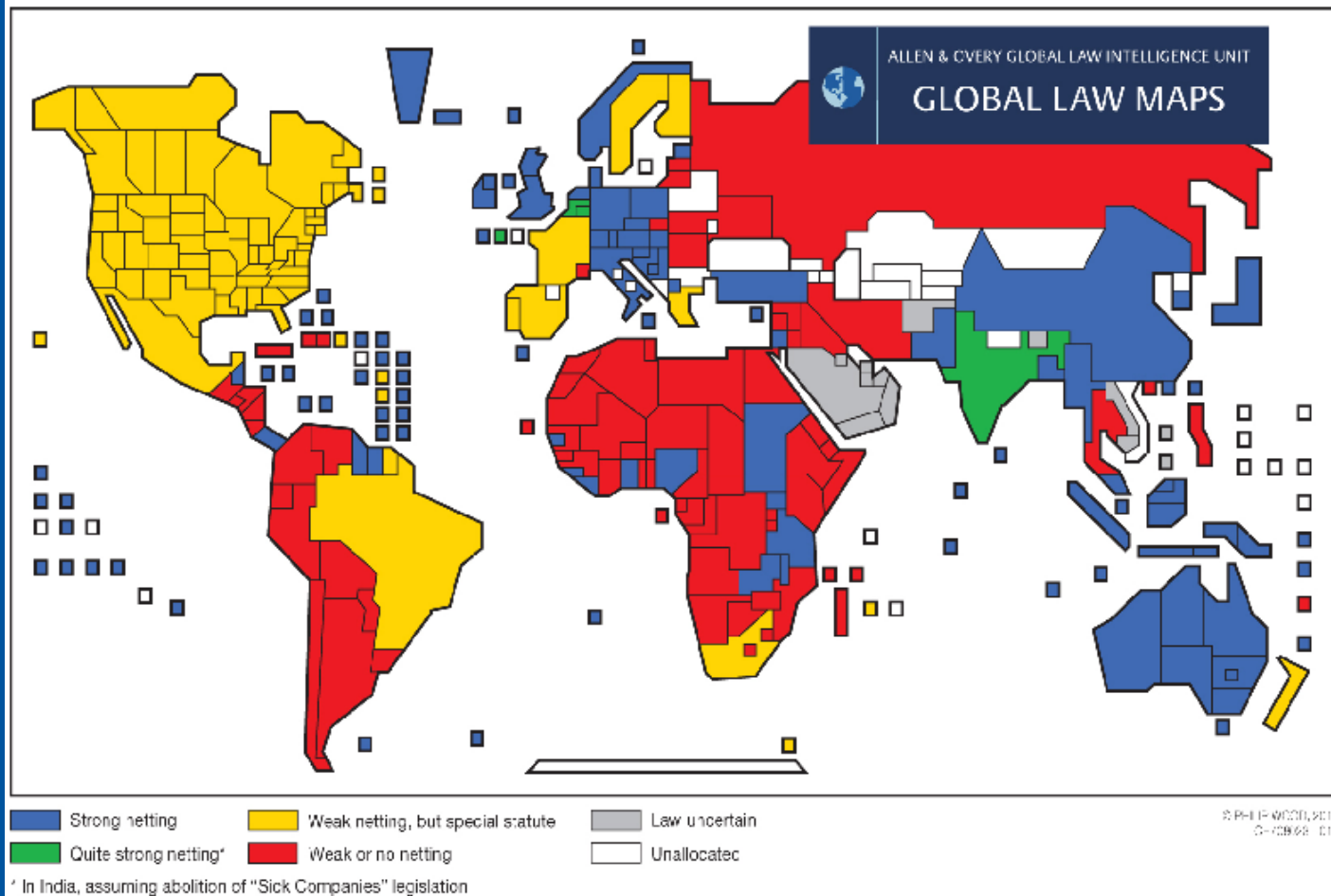
What's next?

- Conflict of law rules
- Mutual recognition of judgments
- Freedom of choice of law governing commercial contracts
- Ditto for choice of court and arbitration agreements
- Cross-border recognition of bank resolution and recovery regimes

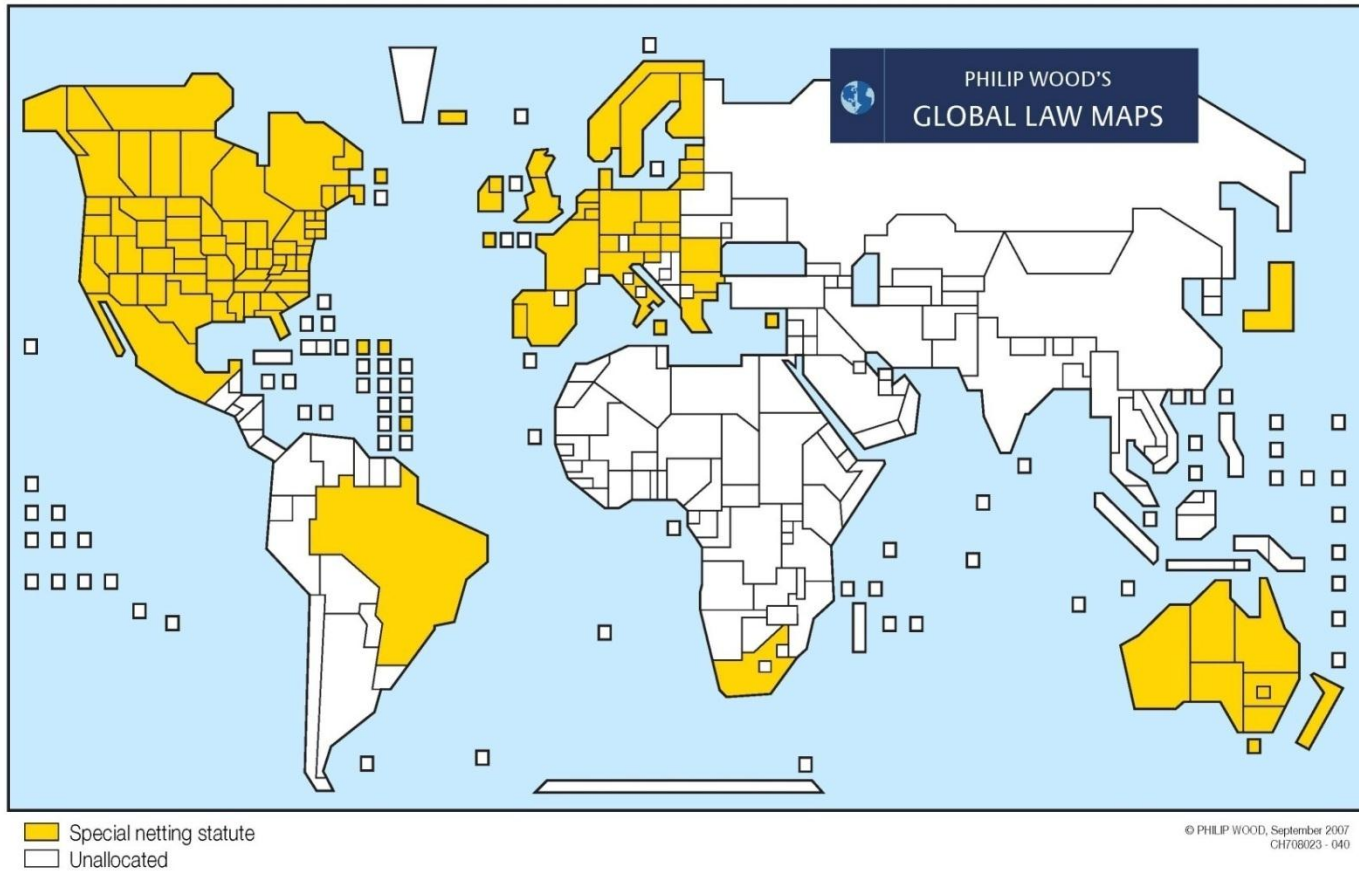
19. Map: Insolvency set-off



20. Map: Close-out netting on insolvency



21. Map: Special netting statutes



For further information

For further information about any of these ISDA projects or to participate in the work of the ISDA Financial Law Reform Committee, contact Peter Werner in London: pwerner@isda.org

ISDA Financial Law Reform Committee

http://www.isda.org/c_and_a/collateralFinancial.html