International Comparative Legal Guides

Derivatives 2020

A practical cross-border insight into derivatives

First Edition

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1 Documentation and Formalities

1.1 Please provide an overview of the documentation (or framework of documentation) on which derivatives transactions are typically entered into in your jurisdiction. If the 1992 or 2002 ISDA Master Agreements are not typically used, please describe the contracts which are used, as well as any appendices or annexures.

Over-the-counter ("**OTC**") derivatives are typically documented under the 1992 or 2002 ISDA Master Agreements, with corresponding ISDA Schedules and ISDA Credit Support Annexes ("**CSAs**") or Credit Support Deeds ("**CSDs**") (see question 2.2). There is considerable scope for negotiation with respect to such arrangements.

Exchange-traded derivatives ("**ETD**"), on the other hand, are not typically negotiated as heavily as OTC derivatives and are therefore more straightforward to document. ETD are usually entered into pursuant to standard documentation which will vary depending on the exchange through which they are cleared. The Futures Industry Association ("**FIA**") has produced the key documentation used in respect of ETD, including a set of business documentation and legal terms suitable for derivatives clearing under a principal-to-principal clearing model.

For the purposes of the remaining questions of this chapter, we will focus our analysis on OTC derivatives transactions.

1.2 Are there any variances in documentation for certain types of derivatives transactions or between certain types of counterparties in your jurisdiction? For example, what differences do you see between over-the-counter ("OTC") and exchange-traded derivatives ("ETD") or for particular asset classes?

Derivatives transactions will likely be documented using the ISDA suite of documentation, regardless of product type or counterparty. Certain bespoke provisions or ISDA protocols (see question 8.1) may be included on a counterparty by counterparty basis or a product by product basis. Counterparties may also enter into ISDA form confirmation agreements which deem an ISDA Master Agreement (and Schedule) to be in place. For example, in certain leveraged finance transactions, in order to hedge interest rate risk under the facilities agreement, the borrower may enter into a fully-paid interest rate cap confirmation only and not the actual ISDA Schedule.

However, there are some differences with respect to commodities derivatives, more specifically in relation to the English physical electricity and power market, whereby the FIA has produced the Grid Trade Master Agreement ("**GTMA**") and its Options Annex (which, in adapted form, is used as an annex to the ISDA Master Agreement).

Similarly, the European Federation of Energy Traders ("**EFET**") has also produced its own documentation with respect to gas and electricity derivatives transactions.

We also see terms of business being used by certain brokers and fintech providers in respect of certain foreign exchange ("**FX**") transactions, particularly when entering into spot FX and, in some cases, FX forwards.

1.3 Are there any particular documentary or execution requirements in your jurisdiction? For example, requirements as to notaries, number of signatories, or corporate authorisations?

There are no particular requirements that apply with respect to derivatives arrangements (such as the ISDA Master Agreement) – they would typically be signed in counterpart without the need for notarisation.

Derivatives arrangements are commonly signed as agreements rather than deeds. However, where security interest is involved, the arrangements will usually be documented in the form of a deed (such as under a CSD), which involves additional requirements. Under English law, a deed must be: (i) in writing; (ii) clear on its face that it is a deed; (iii) validly executed as a deed; and (iv) delivered. Certain title transfer arrangements (such as under a CSA) will typically be documented in the form of agreements.

Corporate authorisations, in the form of board minutes approving entry into the relevant derivatives arrangements, are often required by the sell-side counterparty. A director's certificate may also be required, particularly where a guarantee or other complex security is granted.

1.4 Which governing law is most often specified in ISDA documentation in your jurisdiction? Will the courts in your jurisdiction give effect to any choice of foreign law in the parties' derivatives documentation? If the parties do not specify a choice of law in their derivatives contracts, what are the main principles in your jurisdiction that will determine the governing law of the contract?

We typically see English law-governed documentation. However, the English courts will generally give effect to a choice of foreign law in the parties' derivatives arrangements.

If the parties do not specify a choice of law, the English courts will currently, for contracts concluded on or after 17 December

2009, apply the rules contained in the Rome I Regulation to determine which law shall apply. That will remain the case once the Brexit implementation period expires (which, at the time of writing, is due to expire at 11:00 p.m. on 31 December 2020), as those rules will then be incorporated into domestic law. In very brief summary, the courts will first consider whether the contract falls into one of the special categories listed in the Regulation. Contracts made in regulated financial markets are considered a special category and are governed by the law regulating the relevant market. If the contract falls outside of the special categories, the applicable law will be the law of the country where the party required to effect the characteristic performance of the contract has their habitual residence, unless the contract is manifestly more closely connected with a country other than that, in which case the law of that other country will apply instead.

2 Credit Support

2.1 What forms of credit support are typically provided for derivatives transactions in your jurisdiction?

The typical forms of credit support are:

(i) guarantees;
(ii) conventional security (e.g. debentures, charges over assets, etc.); or
(iii) margin collateral arrangements in the form of the ISDA credit support documentation (see question 2.2).

2.2 How is credit support for derivatives transactions typically documented in your jurisdiction? For example, under an ISDA Credit Support Annex or Credit Support Deed.

In relation to margin collateral arrangements, we traditionally see credit support documented under one of the English law-governed credit support documents published by ISDA, most commonly under a CSA in the form of the 1995 ISDA Credit Support Annex (Transfer – English Law), and in some cases under a CSD in the form of the 1995 ISDA Credit Support Deed (Security interest–English law).

Where the parties are required under the applicable regulation (e.g. under the European Markets and Infrastructure Regulation ("**EMIR**"), see question 2.5) to exchange margin, ISDA has produced additional credit support documents which are commonly used in the UK, including the ISDA 2016 Credit Support Annex for Variation Margin ("**VM**") (Transfer – English Law), the 2016 Phase One IM Credit Support Deed (Security Interest – English Law) and the 2018 Credit Support Deed For Initial Margin ("**IM**") (Security Interest – English Law).

2.3 Where transactions are collateralised, would this typically be by way of title transfer, by way of security, or a mixture of both methods?

CSAs are commonly used in England and Wales when documenting margin arrangements. They typically operate by way of title transfer. Under a CSA, the net out-of-the-money party is required to transfer to its counterparty, at periodic intervals, sufficient liquid assets to collateralise the out-of-the-money amount, subject to an obligation on the counterparty to return equivalent assets if, and to the extent that, the out-of-the-money position improves.

Conversely, CSDs typically operate by way of security interest and are more commonly used in England and Wales in circumstances where the parties are required to comply with the initial margin requirements under EMIR (see question 3.1).

2.4 What types of assets are acceptable in your jurisdiction as credit support for obligations under derivatives documentation?

In relation to non-regulatory margin arrangements, the parties are free to agree on the types of assets that will be exchanged as credit support. Credit support is usually in the form of freely transferable currencies, readily marketable government debt securities (such as UK government bonds), corporate bonds, promissory notes and other transferable securities.

As for regulatory margin arrangements, EMIR provides for specific criteria that need to be satisfied so that certain assets can be admitted as eligible collateral for use as VM or IM (as applicable, see question 2.5 for further details).

2.5 Are there specific margining requirements in your jurisdiction to collateralise all or certain classes of derivatives transactions? For example, are there requirements as to the posting of initial margin or variation margin between counterparties?

EMIR sets out certain margin requirements for counterparties who are in scope (and subject to the more onerous requirements under EMIR, namely FCs and NFC+s, as defined in question 3.1) to exchange margin on their OTC derivatives transactions that are not cleared through a central counterparty ("**CCP**").

The EMIR margin requirements are split into: (i) VM which provides for the exchange of margin on a daily basis by reference to the mark-to-market (or mark-to-model) value of the OTC derivatives transaction; and (ii) IM which is exchanged upon the occurrence of certain events and is segregated from the collecting party's own assets (being typically held with a custodian).

Where the parties are required to exchange regulatory margin, ISDA has produced additional credit support documents which are commonly used in England and Wales. With respect to VM, parties would typically enter into the ISDA 2016 Credit Support Annex for VM (Transfer – English Law) to facilitate compliance with the EMIR VM requirement.

In relation to IM, there is a broader set of documentation that parties will need to discuss and enter into in order to comply with the EMIR IM requirement. The documentation will be driven not only by the regulation, but also by the custodian arrangements that each party must have in place to facilitate compliance with IM.

We typically see parties entering into the 2016 Phase One IM Credit Support Deed (Security Interest – English Law) or the 2018 Credit Support Deed For IM (Security Interest – English Law), together with other supplemental documentation such as custody agreements and/or account control agreements.

2.6 Does your jurisdiction recognise the role of an agent or trustee to enter into relevant agreements or appropriate collateral/enforce security (as applicable)? Does your jurisdiction recognise trusts?

Trusts have played an important part in the English legal system historically and continue to do so today. Trusts come in several different forms (charitable, secret, statutory, constructive, etc.) and will be recognised by English law provided that the trust has been properly constituted and satisfies the "*Three Certainties*". These are certainty of intention (to create the trust), certainty of subject matter (the property or assets of the trust) and certainty of object (clarity as to who the beneficiary will be).

Contemporary trusts are used for a wide variety of purposes ranging from pension schemes to asset and wealth management

structures and are particularly prevalent in finance transactions where assets or security are required to be held for the benefit of a defined group of beneficiaries. In finance transactions, it is common to see a professional *security trustee* hold legal title to secured assets for and on behalf of a lending group and for the security trustee itself (rather than the lenders) to be party to the security documents. In the context of derivatives transactions generally, it is worth noting that custodians tend to hold assets posted as initial margin on trust for the parties.

The position under English law is similar for agents – the law of agency exists at common law, but in finance transactions the role of an agent is typically more specifically defined in the documentation appointing the agent. Indeed, whilst some transactions will employ a security trustee, others will use a *security agent* which will enter into the security documentation. Many structures are established such that only the security trustee/agent can appropriate collateral and/or take enforcement action in relation to the secured assets (usually on the instruction of the other parties to the transaction) and there is no issue as a matter of English law with trustees or agents being involved in transactions in this way (provided that they have been validly appointed).

2.7 What are the required formalities to create and/or perfect a valid security over an asset? Are there any regulatory or similar consents required with respect to the enforcement of security?

Registration requirements depend on the type of secured asset. The majority of secured interests created by a UK registered company or limited liability partnership must be registered with the registrar of companies (Companies House) within 21 days of the security interest being created. Failure to register would result in the security being void against a liquidator, administrator or any creditor of the chargor entity and the monetary obligations secured by it becoming immediately payable.

Another key reason for registering a charge is to try to fix third parties with notice of matters on the register, which could affect the priority of competing claims. For instance those who search the register will have actual notice of restrictions recorded there (e.g. a negative pledge clause) and those reasonably expected to search will be fixed with constructive notice of these matters.

Charge registration at Companies House will be equally relevant where the assets charged are located outside the UK; it is irrelevant that security is granted abroad under a different governing law. Charges over certain assets are excluded from these rules. This potentially includes security over "financial collateral" such as cash, financial instruments and credit claims (claims under loans made by credit institutions). However security documents creating these types of security interests are still commonly registered, due to uncertainty as to whether the financial collateral is "in the possession or under the control of the collateral-taker" (a crucial test for the purposes of the Financial Collateral Arrangements (No 2) Regulations 2003).

To register a charge granted by a UK registered company or LLP, a prescribed form must filed at Companies House, together with a certified copy of the instrument creating the charge and e-filing is now commonplace. Once registered, the charge instrument becomes a public document, accessible via the online register. Note however that this is not a universal perfection filing and does not remove the need to perfect security over certain other assets. It is insufficient to the extent that a charge relates to items for which there is a UK asset-specific register (real estate, intellectual property, ships and aircraft).

Security created by individuals or other unincorporated chargors may need to be registered with the High Court pursuant to the Bills of Sale Acts, which govern the ability of an individual or non-corporate debtor to leverage certain assets as security (although the law in this area is currently being reformed). Companies incorporated outside the United Kingdom cannot register charges at Companies House but remain subject to the rules for registration of security at asset-specific registries.

To perfect security over monetary claims, notice should be served on the counterparty to the claim or receivable, as priority of security over such claims is generally determined by the timing of the giving of such notice.

There are no notarisation requirements for security documents under English law. There will usually be no UK regulatory or similar consents required with respect to the enforcement of security (unless, for instance, it involves enforcement over shares which results in a direct or indirect change of control of a regulated business).

3 Regulatory Issues

3.1 Please provide an overview of the key derivatives regulation(s) applicable in your jurisdiction and the regulatory authorities with principal oversight.

In England and Wales, the key regulations that impact upon the trading of derivatives are as follows:

- EMIR;
- the Markets in Financial Instruments Regulation ("**MiFIR**") and the Markets in Financial Instruments Directive II ("**MiFID II**"); and
- the UK "regulatory perimeter" established by the Financial Services and Markets Act 2000 ("**FSMA**") and the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 ("**RAO**") (which, in part, transposes certain MiFID II requirements).

Both the EMIR and the MiFID II regimes will be "onshored" into English law following the end of the Brexit implementation period (see question 3.2). EMIR is broadly made up of three key pillars: (i) reporting of ETD and OTC derivatives transactions to a trade repository; (ii) mandatory central clearing obligations in relation to specific classes of OTC derivatives (which, for the time being, covers certain classes of interest rate and credit derivatives); and (iii) risk mitigation techniques in respect of all OTC derivatives transactions which are not subject to mandatory central clearing under (ii). EMIR provides for a set of requirements that will apply differently to market participants that are incorporated in the European Economic Area (the "**EEA**") depending on their categorisation under the regulation as either financial counterparties ("**FCs**") or non-financial counterparties ("**NFCs**").

FCs typically include banks, credit institutions, alternative investment funds, UCITS, certain pension scheme arrangements and insurance providers, and the impact of such classification is that they will typically be subject to more significant regulatory obligations when compared with NFCs, most notably the obligation to clear and collateralise certain derivatives transactions. EMIR was amended in June 2019 by the European Commission's regulatory fitness and performance programme ("**EMIR REFIT**"), with a key change being an amendment to the definition of FC, which has not only been broadened to capture a wider range of alternative investment funds, but has also seen the introduction of a Small Financial Counterparty ("**SFC**") category which is exempt from the EMIR clearing requirement.

NFCs include all entities that are not FCs. EMIR subdivides NFCs into two groups: (i) NFCs above the clearing threshold ("**NFC+s**"); and (ii) NFCs below the clearing threshold ("**NFC-s**"). In order to determine whether an NFC is an NFC+

or an NFC-, it is necessary to establish whether the aggregate month-end average gross notional position of all OTC derivatives transactions (for the previous 12 months) entered into by that NFC and all the NFCs within the NFC's group exceeds any clearing threshold. Derivatives transactions that are objectively measurable as risk-reducing are excluded from the calculation. Broadly, an entity will be an NFC+ if such calculation exceeds any of the "clearing thresholds" set out under EMIR (EUR 1bn (in respect of credit or equity derivatives) and EUR 3bn (in respect of interest rate, FX or commodities and other derivatives)). If an entity is an NFC+, it will be subject to more onerous obligations similar to an FC.

Any entity that is incorporated outside the EEA (also known as a third-country entity ("**TCE**")) and enters into derivatives transactions with a counterparty that is incorporated in the EEA will not generally of itself be subject to the EMIR requirements. However, the EEA counterparty will be subject to the relevant EMIR requirements, and the TCE will be expected to enter into derivatives transactions on terms that will enable the EEA counterparty to comply with its EMIR requirements. A TCE's EMIR classification will depend on how that TCE would be classified if it were incorporated in the EEA (i.e. its deemed classification). Further detail on EMIR, an entity's counterparty classification and the relevant applicable obligations require a more comprehensive legal analysis on a case-by-case basis.

MiFID II (alongside MiFIR) provides the framework for the regulation of investment firms and their investment activities in the EEA. Broadly speaking, the MiFID II regime applies to investment firms carrying out certain investment services and activities: trading in a wide variety of derivatives instruments is caught. Investment firms are required to be authorised by the national competent authority ("**NCA**") in the Member State where they have their registered office. UK investment firms are therefore authorised by the Financial Conduct Authority ("**FCA**"), with a handful of very large investment banks also being prudentially supervised by the Prudential Regulation Authority ("**PRA**"). MiFID II also imposes conduct of business rules and organisational requirements, and creates the concept of the "EU Passport" which enables an investment firm authorised in one Member State to provide services in another (without additional authorisation) (although this will soon not apply to the UK – see question 3.2).

3.2 Are there any regulatory changes anticipated, or incoming, in your jurisdiction that are likely to have an impact on entry into derivatives transactions and/or counterparties to derivatives transactions? If so, what are these key changes and their timeline for implementation?

A key incoming change is the impact that Brexit (and any negotiated Brexit deal) will have on derivatives arrangements following the expiry of the implementation period (which commenced on 31 January 2020 and which, at the time of writing, is due to expire at 11:00 p.m. on 31 December 2020). Following such date, EMIR will be "onshored" into UK law via statutory instruments, with some modifications replacing EU terms and references to regulatory authorities with the UK equivalents ("**UKMIR**"). As at the date of publication, UKMIR does not seek to make substantive changes to the terms of EMIR. Instead, the purpose of UKMIR is to ensure that the new regime operates effectively in the UK after the end of the Brexit implementation period. Some of the key changes that are expected to arise under UKMIR essentially involve: (i) a transfer of functions from EU to UK authorities; (ii) amendments to certain definitions; (iii) updated processes; (iv) the introduction of an intragroup clearing exemption; and (v) changes to the way a clearing exemption that is currently available to certain EEA pension scheme arrangements will apply to UK pension schemes.

There is also an incoming development relating to the uncleared margin regime. The EMIR IM requirement (which is only relevant to certain NFC+s and FCs (including entities not incorporated or domiciled in the EEA, but that are otherwise treated as "*deemed* FCs" and "*deemed* NFC+s")) is being phased-in under EMIR and it currently applies only to the largest users of OTC derivatives transactions. These are users whose outstanding aggregate average notional amount ("**AANA**") of non-centrally cleared OTC derivatives transactions exceeds EUR 0.75 trillion. The upcoming phase-in thresholds have recently been updated by the International Organisation of Securities Commissions ("**IOSCO**") and will be formalised by way of regulatory technical standards which are currently in draft form and which should reflect the following position:

(i) under the new phase five, those with an AANA of non-centrally cleared OTC derivatives (in most cases on a group wide basis) above EUR 50 billion will be required to exchange IM from 1 September 2021; and

(ii) under the sixth and final phase, those with an AANA of non-centrally cleared OTC derivatives (in most cases on a group wide basis) above EUR 8 billion will be required to exchange IM from 1 September 2022.

Similar "onshoring" of the MiFID II regime into UK law will take place at the end of the implementation period, following which there will no longer be an "EU Passport" of investment services from, or into, the UK.

3.3 Are there any further practical or regulatory requirements for counterparties wishing to enter into derivatives transactions in your jurisdiction? For example, obtaining and/or maintaining certain licences, consents or authorisations (governmental, regulatory, shareholder or otherwise) or the delegating of certain regulatory responsibilities to an entity with broader regulatory permissions.

Broadly, UK sell-side firms require FCA authorisation to carry on regulated activities and require permission for each type of specified activity they propose carrying on. Credit institutions and the largest investment banks will be prudentially regulated by the Prudential Regulation Authority ("**PRA**") and subject to conduct of business regulation by the FCA and will therefore be dual-regulated. All other firms will be solo-regulated by the FCA. If the firm's activities include entering into derivatives transactions as principal with counterparties, then each of those transactions, depending on its individual characteristics, will be defined in regulatory terms as an option, a future or a contract for differences. The firm's scope of permission, which appears on the Financial Services Register maintained by the FCA, should reflect this and will likely show permission to deal as principal in relation to all three – i.e. options, futures and contracts for differences (with some subdivisions for, e.g., commodity derivatives, spread bets and rolling spot forex contracts).

When entering into ISDA Master Agreements, counterparty banks often require their buy-side counterparties to obtain corporate authorisation in the form of a board minute and/or shareholder resolution approving the entry into the agreement and any derivatives transactions thereunder.

3.4 Does your jurisdiction provide any exemptions from regulatory requirements and/or for special treatment for certain types of counterparties (such as pension funds or public bodies)?

Under EMIR, certain pension scheme arrangements are exempt from the EMIR clearing obligation – this exemption is set to expire on 18 June 2021. However, it is expected that UKMIR will provide that such exemption runs at least until 18 June 2023.

There is also an exemption from the clearing obligation under EMIR for certain intragroup derivatives transactions provided that certain criteria are met. To benefit from this exemption, counterparties must submit applications to the FCA.

4 Insolvency/Bankruptcy

4.1 In what circumstances of distress would a default and/or termination right (each as applicable) arise in your jurisdiction?

This will typically be dealt with by the "Bankruptcy" event of default at Section 5(a)(vii) of the 1992 and 2002 ISDA Master Agreements. Broadly, bankruptcy is stated to have occurred where the party, any credit support provider of such party or any applicable entity specified in the Schedule in relation to such party:

(i) is dissolved;
(ii) becomes insolvent or is unable to pay its debts;
(iii) makes a general assignment, arrangement or composition with or for the benefit of its creditors;
(iv) institutes or has instituted against it a proceeding seeking a judgment of insolvency, bankruptcy or similar, or is presented with a petition for its winding-up or liquidation;
(v) has a resolution passed for its winding-up, official management or liquidation;
(vi) seeks or becomes subject to the appointment of an administrator, provisional liquidator, conservator, receiver, trustee, custodian or similar official;
(vii) has a secured party take possession of its assets or has a distress, execution, attachment, sequestration or other legal process levied, enforced, or sued on or against its assets and such secured party maintains possession, or any such process is not dismissed, discharged, stayed or restrained shortly thereafter;
(viii) causes or is subject to any event analogous to the above; or
(ix) takes any action in furtherance of, or indicating its consent to, approval of, or acquiescence in, any of the above acts.

Whilst not specifically related to distress, a party in distress should also be aware of the other events of default and termination events contained in Section 5 of the ISDA Master Agreement (including failure to pay, misrepresentation and cross-default provisions), as they may also be at risk of triggering one of these if they are in a distressed scenario.

4.2 Are there any automatic stay of creditor action or regulatory intervention regimes in your jurisdiction that may protect the insolvent/bankrupt counterparty or impact the recovery of the close-out amount from an insolvent/bankrupt counterparty? If so, what is the length of such stay of action?

If the counterparty is in administration, an automatic statutory moratorium applies which prevents the enforcement of security rights and the commencement of legal proceedings against the counterparty, save with the permission of the court. This moratorium commences on an interim basis on the presentation to court of an administration application or the filing with the court of a notice to appoint an administrator. The interim moratorium becomes permanent upon the appointment of the administrator.

Whether or not a moratorium applies in liquidation depends upon the type of liquidation:

(i) if it is a compulsory liquidation, a moratorium applies which prevents creditor action against the counterparty without the permission of the court;
(ii) in a creditors' voluntary liquidation, there is no automatic moratorium, but the liquidator may apply to court to have creditor action stayed in certain circumstances; and
(iii) in a company voluntary arrangement, a 28-day moratorium applies on a limited basis for a counterparty that is below a prescribed size (targeted at small companies).

The Government has stated its intention to introduce a new moratorium procedure that will apply pre-insolvency to allow a distressed company to consider its options for rescue. This moratorium will apply to creditor enforcement. It is not clear when this legislation will be implemented.

Security over financial collateral is given a statutory exemption from moratoria on security enforcement if the relevant statutory requirements are satisfied.

Where the counterparty is a credit institution or investment firm, a dedicated statutory regime applies under the Banking Act 2009, under which authorities have broad powers to impose stays on enforcement (and further to limit creditor rights) in seeking a bank resolution of the counterparty. Furthermore, the Banking Act 2009 was amended following the EU's introduction of The Bank Recovery and Resolution Directive ("**BRRD**") in order to provide national authorities (being the FCA, PRA, Bank of England and the Treasury in the UK) with comprehensive and effective arrangements to deal with banks failing at a national level, as well as cooperation arrangements to deal with any cross-border banking failures. This includes powers to ensure an orderly resolution of a failing bank. Banks are also required to prepare recovery plans to deal with financial difficulties or distress. Following the expiry of the Brexit transition period, the Financial Services and Markets Act 2000 and the Banking Act 2009 will continue to operate to enable UK banks to cooperate with EEA counterparts.

4.3 In what circumstances (if any) could an insolvency/bankruptcy official render derivatives transactions void or voidable in your jurisdiction?

An insolvency practitioner does not have an inherent power to declare a transaction void or voidable with legal effect. However, there are a number of grounds on which a derivatives transaction (including any related security or collateral arrangements) could be void or voidable. If an insolvency practitioner considers that one of these grounds applies, they will seek to have the relevant transaction set aside and court action may be required to determine whether the transaction is void or voidable.

The primary grounds that would make a derivatives transaction voidable are the rules on antecedent transactions (see question 4.4). In addition, there are statutory and common law rules under which a derivatives transaction could be voided, such as the rules against fraud or terms that constitute penalties, or where the transaction is structured in breach of the anti-deprivation principle (a rule that an arrangement may be void if it would remove an asset from an insolvent estate that would otherwise be available to be realised for the benefit of creditors).

4.4 Are there clawback provisions specified in the legislation of your jurisdiction which could apply to derivatives transactions? If so, in what circumstances could such clawback provisions apply?

Yes. The Insolvency Act 1986 contains a regime for the setting aside of prior transactions in certain circumstances. The court has broad discretion to make such remedial orders as it sees fit, including for the return of payments made.

The antecedent transactions regime applies to several different categories of voidable transaction, of which the key two are:

(i) *Preferences*: these are transactions where a creditor or guarantor of the counterparty is put into a better position than it would otherwise have been in a winding-up of the counterparty. To be a preference, a transaction must be motivated by a desire in the counterparty to prefer the creditor or guarantor. This is presumed if the transaction is with a person connected with the counterparty.

(ii) *Transactions at an undervalue*: these are transactions made by the insolvency counterparty at an undervalue. There is a defence if the counterparty enters into the transaction in good faith and has reasonable grounds for believing that the transaction would benefit the counterparty.

The potential look-back period is two years (for transactions at an undervalue and preferences entered into by the counterparty with a connected person) or six months (for preferences entered into by the counterparty with an unconnected person). However, for transactions at an undervalue entered into with the substantial purpose of defrauding creditors, no such limits on look-back apply.

A transaction will only constitute a preference or transaction at an undervalue if the counterparty was unable to pay its debts at the time of the transaction or as a result of the transaction. Inability to pay debts can mean either cashflow or balance sheet insolvency. Inability to pay debts is presumed with a transaction at an undervalue between the counterparty and a connected party.

The test of connection for these purposes is very broad, including group companies, directors and employees.

Other types of transaction that may be voidable are floating charges (which are subject to a "hardening period" of up to two years during which the charge will only secure the value of consideration actually given in return for the charge).

A disposition of property by a company made after a winding-up petition has been made in respect of it is void if the winding-up order is granted.

4.5 In your jurisdiction, could an insolvency/bankruptcy related close-out of derivatives transactions be deemed to take effect prior to an insolvency/bankruptcy taking effect?

The market view is that an insolvency/bankruptcy related close-out, if elected for under the Automatic Early Termination ("**AET**") provisions of the English law ISDA Master Agreement, could be deemed to take effect prior to the relevant insolvency/bankruptcy taking effect. However, it is accepted that it is possible that an English court would not give effect to this intended retroactive effect.

4.6 Would a court in your jurisdiction give effect to contractual provisions in a contract (even if such contract is governed by the laws of another country) which have the effect of distributing payments to parties in the order specified in the contract?

The English courts would be expected to apply the provisions of a contract around the distribution of payments, unless the provisions are contrary to relevant requirements of English law.

Of primary concern would be the English insolvency rules, if any of the relevant parties is in an English insolvency procedure. It is not possible to contract out of the English law order of priorities on insolvency and mandatory set-off in relation to certain debts owed to and by a party that enters an administration or liquidation procedure. A disposition of a company's property after it is wound up is void unless approved by the court.

The English courts may recognise the overriding nature of insolvency rules of other jurisdictions where the relevant parties are subject to those rules. However, the English courts will not enforce contractual terms requiring payments that would be illegal under English law. This is the case whether or not the contract is subject to foreign law.

5 Close-out Netting

5.1 Has an industry standard legal opinion been produced in your jurisdiction in respect of the enforceability of close-out netting and/or set-off provisions in derivatives documentation? What are the key legal considerations for parties wishing to net their exposures when closing out derivatives transactions in your jurisdiction?

Yes, the most recent update to the English law netting opinion was promulgated on 12 March 2019.

Broadly, under English law, the netting provisions contained in the ISDA Master Agreement are valid and enforceable provided that both counterparties are solvent. Equally, although there are several different flavours of "set-off" under English law, we would expect the contractual set-off provisions in the ISDA Master Agreement to be valid and enforceable where both parties are solvent.

Although the legal analysis becomes more complicated, in the majority of circumstances we expect the netting and set-off provisions in the ISDA Master Agreement to remain valid and enforceable where one party is subject to insolvency proceedings (a winding-up, administration, etc.). In these scenarios, the provisions in the ISDA Master Agreement must be considered in the light of, among other things, the anti-deprivation principle, the *pari passu* rule and the insolvency set-off rules.

In addition to the legal aspects, other contractual variables applicable to close-outs will also need to be considered, such as: whether AET has been switched on; the nature of the parties (e.g. whether the defaulting party is a multibranch entity); and whether the close-out netting has arisen as a result of an event of default or an additional termination event.

5.2 Are there any restrictions in your jurisdiction on netting in respect of all derivatives transactions under a single master agreement, including in the event of an early close-out?

In the majority of cases (where both parties are solvent), the payment netting and close-out netting provisions in the ISDA Master Agreement are valid and enforceable. Accordingly, there are usually no issues from a legal perspective with the parties electing to apply the "Multiple Transaction Payment Netting" provisions in Section 2(c). On a more practical level though, one of the parties must have established internal systems that can facilitate Multiple Transaction Payment Netting. Whilst many banks do offer this service it is not universally available and we advise buy-side entities to check this point at the outset if the intention is for Multiple Transaction Payment Netting to apply.

As discussed above, more careful consideration is required when assessing the enforceability of the netting provisions (be they "transaction" or "close-out") where one party is subject to insolvency proceedings. However, we expect the netting provisions in the ISDA Master Agreement to be valid and enforceable in most cases where one party is subject to insolvency proceedings.

5.3 Is Automatic Early Termination ("AET") typically applied/disapplied in your jurisdiction and/or in respect of entities established in your jurisdiction?

AET is usually disapplied for ISDA agreements between counterparties incorporated in England and Wales as insolvency practitioners are not permitted, as a matter of English law, to "cherry-pick" transactions (a process by which an insolvency practitioner is allowed to elect which of an insolvent party's transactions are enforceable, resulting in the defaulting party's in-the-money transactions being payable and the out-of-the-money trades falling away, disadvantaging the non-defaulting party).

5.4 Is it possible for the termination currency to be denominated in a currency other than your domestic currency? Can judgment debts be applied in a currency other than your domestic currency?

Yes, the parties are entitled to elect any currency as the termination currency.

Provided that insolvency proceedings are not applicable, the English court can determine judgments in a currency other than Pounds Sterling ("**GBP**"). However, in order to ensure that the judgment is enforceable, any amount payable must be converted into GBP, so that the appropriate enforcement steps can be taken and so that it can be shown when the requirements of the judgment have been satisfied. So, whilst judgments can be made in any currency, in practice judgment debts are settled in GBP.

A further point to note is that no English court has made a ruling on the contractual currency provisions in Section 8 of the ISDA Master Agreement. The prevailing view is that the currency indemnity contained within Section 8 (covering losses occasioned by rates movements) would not be effective against a counterparty from the moment that a winding-up order is made against that counterparty.

6 Taxation

6.1 Are derivatives transactions taxed as income or capital in your jurisdiction? Does your answer depend on the asset class?

Under the UK's "derivative contracts regime", the tax treatment of derivatives transactions falling within the regime follows the accounting treatment. Income from derivatives transactions is usually taxed as income. However, amounts arising from transactions involving certain property derivatives and certain embedded derivatives, although falling within the regime, are taxed as chargeable gains (capital) instead of trading or non-trading income.

6.2 Would part of any payment in respect of derivatives transactions be subject to withholding taxes in your jurisdiction? Does your answer depend on the asset class? If so, what are the typical methods for reducing or limiting exposure to withholding taxes?

There is an exemption from withholding tax for derivatives transactions taxed under the derivative contracts regime.

6.3 Are there any relevant taxation exclusions or exceptions for certain classes of derivatives?

Broadly, derivatives transactions will need to be accounted for as derivatives in order to be within the derivative contracts regime (although there are some limited exceptions).

The following derivatives transactions are excluded from the derivative contracts regime (even if they are accounted for as derivatives): (i) options or futures over intangible fixed assets; and (ii) certain derivative transactions where the underlying subject matter is shares or units in a unit trust. Such excluded derivatives transactions will still be subject to UK corporation tax.

7 Bespoke Jurisdictional Matters

7.1 Are there any cross-border issues that apply when posting or receiving collateral with foreign counterparties? For example, are there any restrictions in your jurisdiction on the delivery or acceptance of foreign currencies?

There are no general cross-border collateral restrictions *per se*, although the location of the counterparty to a derivatives transaction may result in certain cross-border considerations, be it around bespoke taxation, insolvency or other rules and regulations that affect the exchange of collateral.

It is important to note that all claims under an English law bankruptcy, insolvency or liquidation may require debts to be converted into GBP at the prevailing exchange rate.

Furthermore, English courts have the power to give judgment expressed as an order to pay in a currency other than GBP, but may decline to do so at their discretion.

7.2 Are there any restrictions on transferability, for example, assignment and novation (including notice mechanics, timings, etc.)?

There are no general restrictions on the transferability of derivatives transactions, however, under English law, contracts may be assigned only so that the benefit of the contract is transferred. The burden of the contract will remain with the original party, which may or may not be suitable for the needs of the parties.

Given the above, the rights and obligations under the ISDA may only be transferred in their entirety through novation. This involves closing out the existing transactions and entering into a new novated agreement under which the new transactions will fall. If no consideration is being exchanged as part of this process, the novation should be executed as a deed (however, it is likely there will be sufficient consideration to prevent this requirement).

With regard to the transfer of security, the Financial Collateral Arrangements (No.2) Regulations 2003 may apply to an exchange of collateral under a derivatives transaction. The Regulations prescribe a minimum legal framework for financial collateral arrangements which is beyond the scope of this publication.

7.3 Are there any other material considerations which should be taken into account by market participants wishing to enter into derivatives transactions in your jurisdiction?

As the UK has now left the EU, it is likely that new regulatory

and trading regimes will apply upon the end of the implementation period on 31 December 2020. The UK is likely to adopt its own form of EMIR pursuat to UKMIR (as set out in The Over the Counter Derivatives, Central Counterparties and Trade Repositories (Amendment, etc., and Transitional Provision) (EU Exit) Regulations 2018, 2019 and 2020), but the exact form of this is still to be confirmed given the ongoing negotiations around Brexit and the relationship that will subsist between the EU and the UK.

In addition, the discontinuation of the London Interbank Offered Rate ("**Libor**") may cause some disruption to derivatives transactions. Libor is a benchmark rate at which banks are willing to borrow unsecured funds. It is administered by ICE Benchmark Administration and is currently an embedded feature of many financial contracts, including derivatives documentation, for the calculation of interest rates payable between counterparties. However, its publication beyond 2021 is no longer guaranteed as financial markets are planning to transition towards alternative risk-free rates. The market is still working towards consensus on not just the replacement rate which will be used, but how contracts will envisage the operation of a fallback rate to be applicable to counterparties following the cessation of Libor's publication and/or the removal of regulatory support for its continued use as an appropriate and robust benchmark rate.

At the time of writing, it is worth noting that the Corporate Insolvency and Governance Bill is being debated in the UK Parliament – this new piece of legislation is not expected to have a significant impact on UK financial services, but this is one to watch.

8 Market Trends

8.1 What has been the most significant change(s), if any, to the way in which derivatives are transacted and/or documented in recent years?

The derivatives market has become substantially more regulated over the past years which resulted in changes to the way derivatives are transacted and documented. In some cases additional provisions and/or documents are required to be used by the parties to reflect updates to the parties' operational processes in line with the regulations (such as with reporting, regulatory margin and portfolio reconciliation).

We have seen an increased number of protocols being produced by ISDA to facilitate amendments by parties to their contractual arrangements, including in response to various recent regulatory developments, e.g., the ISDA 2018 Benchmarks Supplement Protocol and the ISDA 2018 U.S. Resolution Stay Protocol.

8.2 What, if any, ongoing legal, commercial or technological development do you see as having the greatest impact, positive or negative, on the market for derivatives transactions in your jurisdiction?

There is an increased focus on the use of smart contracts and other technological tools (including in relation to the valuation of contracts and collateral) in the derivatives space. These initiatives will be beneficial to the market in the long term.

8.3 In your view, what are the key market trends likely to affect derivatives transactions in your jurisdiction in the upcoming years? For example, the key negotiated commercial terms, the volume of trades and/or the main types of products traded, smart contracts or other technological solutions.

As mentioned in question 8.2 above, one of the key market trends is the potential use of smart contracts in the derivatives market. ISDA has set up various initiatives and published guidelines to facilitate this.

We also expect the upcoming discontinuation of Libor to have an effect on the way interest rate derivatives are put in place – this will likely have an effect on the volume of Libor-linked transactions going forward. Further documents are expected to be published by ISDA (including a new protocol) this year to address Libor discontinuation and to assist counterparties when transitioning from Libor to replacement benchmarks – they will include the fallback provisions that apply upon the occurrence of certain cessation and pre-cessation triggers in respect of Libor.

At the time of writing we are in the midst of the COVID-19 pandemic – whilst the situation is still evolving, this has already had a substantial effect on the derivatives market. It has impacted the way derivatives transactions are being executed, with an increased number of parties making use of electronic signatures. It has also had an impact on systems and operations, highlighting the importance for counterparties to have business continuity processes in place. Some of the existing provisions in the standard ISDA documentation (such as the *force majeure* and notice provisions included in the 2002 ISDA Master Agreement) are currently being tested and it will be interesting to see how the market will adapt to the circumstances.

Jonathan Gilmour is a partner at Travers Smith and heads its Derivatives & Structured Products team. He specialises in derivatives and structured products from both a transactional and advisory standpoint. He is widely regarded by peers and clients as one of the leading specialists in his field. He counts among his clients some of the UK's largest and most sophisticated financial institutions, investment managers, private equity houses, challenger banks and occupational pension schemes.

Jonathan regularly negotiates and advises on ISDA, GMRA and GMSLA documentation as well as the impact of related regulation including EMIR and SFTR. He also advises on the structure and documentation of bespoke transactions to hedge exposure to key market risks, including interest rate, inflation, FX and longevity; and advises on investment management, custody, clearing and collateral management arrangements, as well as pension scheme funding and risk transfer arrangements.

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