International
Comparative
Legal Guides

Practical cross-border insights into derivatives law

Derivatives 2023

Fourth 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. Please note whether there are variances in the documentation for certain types of derivatives transactions or counterparties; for example, differences between over-the-counter ("OTC") and exchange-traded derivatives ("ETD") or for particular asset classes.

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 2.1). 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.

OTC derivatives transactions are usually 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.

1.2 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.

1.3 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, for contracts concluded on or after 17 December 2009, but before the expiry of the Brexit implementation period at 11pm on 31 December 2020, the English courts will apply the rules contained in the Rome I Regulation to determine which law shall apply. For contracts concluded after 11pm on 31 December 2020 that do not specify a choice of law, the English courts will apply the rules contained in the Rome I Regulation as incorporated into domestic law (with some minor amendments). In very brief summary, the

courts will first consider whether the contract falls into one of the special categories listed in the Rome I 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? How is this typically documented? For example, under an ISDA Credit Support Annex or Credit Support Deed.

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.

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. Where the parties are not within scope of mandatory regulatory margin rules, these would be in the form of either the 1995 ISDA Credit Support Annex (Transfer – English Law), or 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**") and its UK equivalent ("**UK EMIR**"); see questions 2.4 and 3.1) to exchange margin, ISDA has produced additional credit support documents that are commonly used in the UK, including the ISDA 2016 Credit Support Annex for Variation Margin ("**VM**") (Transfer – English Law), and the 2018 Credit Support Deed for Initial Margin ("**IM**") (Security Interest – English Law), among others.

2.2 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. A CSA operates by way of title transfer of the collateral. Under a CSA, subject to pre-agreed minimum transfer amounts and collateral thresholds, the net out-of-the-money party is required to transfer to its counterparty, at periodic intervals, sufficient liquid assets to collateralise the amount of its counterparty's exposure subject to an obligation on the counterparty to return equivalent assets if, and to the extent that, the exposure reduces or moves in the other direction.

Conversely, CSDs create a security interest over the collateral and are more commonly used in England and Wales in circumstances where the parties are required to comply with the IM requirements under EMIR or UK EMIR (see question 3.1).

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

Unless parties are bound by regulatory margin requirements, they are free to agree the types of assets that will be exchanged as credit support. Credit support is usually in the form of cash, 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 and UK EMIR specify that qualifying assets can be admitted as eligible collateral for use as VM or IM (as applicable; see question 2.4 for further details).

2.4 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 and UK EMIR require certain counterparties (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/UK 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 must be provided to cover the potential exposure in the collateral between the last collection of margin and the liquidating or hedging of potential following a default of the other counterparty 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 that are aimed at facilitating compliance with regulatory requirements commonly used in England and Wales. With respect to regulatory VM, parties would typically enter into the ISDA 2016 Credit Support Annex for VM (Transfer – English Law) to facilitate compliance with the EMIR or UK EMIR VM requirement.

In relation to regulatory IM, there is a broader set of documentation that parties will need to discuss and enter into in order to comply with the EMIR/UK 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.

2.5 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 IM 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).

2.6 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 ("**LLP**") 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 be 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 specific 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. Companies incorporated outside the UK 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). A secured creditor contemplating the enforcement of security over shares in certain protected sectors may be required to apply for government clearance under the National Security and Investment Act 2021.

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/UK EMIR (depending on the jurisdiction of establishment of the counterparties);
- the "MiFID II regime" as onshored in the UK, including the Financial Services and Markets Act 2000 (Markets in Financial Instruments) Regulations 2017/701 (which originally transposed the EU MiFID II Directive) (the "**UK MiFI Regulations**"), the Markets in Financial Instruments Regulation ("**UK 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 and now incorporates certain changes reflecting the onshoring of the MiFID II regime).

EMIR and UK EMIR are broadly made up of three key pillars: (i) reporting of ETD and OTC derivatives transactions to a trade repository recognised by the European Securities and Markets Authority ("**ESMA**") or the Financial Conduct Authority ("**FCA**") for EMIR and UK EMIR, respectively; (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 that are not subject to mandatory central clearing under (ii). The various requirements of EMIR/UK EMIR apply to counterparties based on their categorisation under the regulation as either financial counterparties ("**FCs**") or non-financial counterparties ("**NFCs**").

FCs typically include banks, investment firms, alternative investment funds ("**AIFs**"), 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. An FC whose OTC derivatives trading activity falls below all clearing thresholds (as specified below) qualifies as a small FC ("**SFC**") and is exempt from the EMIR/UK EMIR clearing requirement.

NFCs include all entities that are not FCs. EMIR/UK 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/UK EMIR (EUR 1 billion (in respect of credit or equity derivatives) and EUR 3 billion (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.

Under EMIR, if an FC or NFC exceeds any of the clearing thresholds, it must notify the relevant National Competent Authority ("**NCA**") and ESMA. Under UK EMIR, if an FC or NFC exceeds any of the clearing thresholds, it must notify the FCA.

Any third-country entity ("**TCE**") that is incorporated outside the UK (in respect of UK EMIR) or outside the European Economic Area ("**EEA**") (in respect of EMIR) is not directly in-scope of EMIR/UK EMIR, but will nevertheless need to enter into derivatives transactions on terms that will enable the UK/EEA counterparty to comply with its EMIR/UK EMIR requirements, as applicable. The UK or EEA entity will treat the TCE for this purpose as though it is classified as an FC (and either an SFC or a large FC), NFC+ or NFC- according to how that TCE would be classified if it were incorporated in the UK/EEA (its "*deemed*" status). As at the date of this policy, UK entities are TCEs under EMIR, and EU entities are TCEs under UK EMIR. Further detail on EMIR/UK EMIR, an entity's counterparty classification and the relevant applicable obligations require a more comprehensive legal analysis on a case-by-case basis.

Market participants should note that there are some key differences between EMIR and UK EMIR. These include areas of growing regulatory divergence, including differences in the way in which derivatives need to be reported – see question 8.2.

In particular, EMIR requires that certain classes of cleared derivatives must be executed on a trading venue recognised by EU regulators or regulators in a jurisdiction whose regulatory regime is determined by the EU Commission to be "equivalent" to that in the EU. As no equivalence decision has (at the time of writing) been made by the EU Commission in respect of UK trading venues, counterparties subject to EMIR who execute derivatives transactions on markets in the UK will have to count those transactions towards the relevant clearing thresholds where applicable. Counterparties may find themselves required to clear derivatives executed on exchange for the first time as a result.

Counterparties to derivatives transactions may be required to comply with certain contractual and regulatory obligations during the life of a derivatives transaction; e.g. the rolling of open positions, portfolio compression, exercise of options, and unwinds and novations. The loss of UK firms' "passport", which allowed them to conduct investment business in the EU prior to Brexit, has created some complexity surrounding continuing conduct of these cross-border activities between the UK and EEA States where counterparties trade in derivatives as a business activity. These issues are wide-ranging and will differ according to the EEA Member State(s) in which the activity takes place.

Another difference between EMIR and UK EMIR relates to the clearing exemption available to certain pension scheme arrangements (see question 3.4).

The MiFID II regime was "onshored" into UK law as of 11pm on 31 December 2020 and comprises (among other things) the UK MiFI Regulations, UK MiFIR, onshored versions of Level 2 delegated acts and a host of binding technical standards. The overall substance of that regime remains the same as before, although there is no longer any "passporting" of investment services from the UK into the EU (nor any passporting of investment services from the EU into the UK, although there were some transitional arrangements that, subject to conditions, effectively preserved the *status quo* for a limited period for those incoming firms that had notified the FCA).

There are also some other changes resulting from the UK's departure from the EU, including, for instance, with regard to the "domestication" of MiFID transaction and trade reporting. The UK MiFID regime (like the EU regime from which it is derived) has a "third-country regime" under which firms from non-UK countries (including the EEA) will be able to access the UK market, although that will be predicated upon an "equivalence decision" being made in relation to each country, together with other requirements.

Broadly speaking, the UK MiFID II regime applies to UK investment firms carrying out certain investment services and activities: trading in a wide variety of derivatives transactions is caught. UK investment firms are authorised by the FCA, with a handful of very large investment banks also being prudentially supervised by the Prudential Regulation Authority ("**PRA**"). UK credit institutions (who are subject to the onshored Capital Requirements Directive and Capital Requirements Regulation regime ("**CRD V/CRR II**") and who are dual-regulated by the PRA and FCA) are also subject to specific provisions under MiFID II. MiFID II also imposes conduct of business rules requirements (e.g. relating to best execution and reporting) and organisational requirements (e.g. relating to governance, outsourcing, conflicts of interest and inducements).

Some changes to the UK MiFID II regime will be made by the Financial Services and Markets Bill 2022–23 (which, at the time of writing, is progressing through Parliament). These changes will include adjustments to the derivatives trading obligation ("**DTO**") under UK MiFID II (see question 3.2 for further details) and a mechanism by which, in time, all retained EU law listed in Schedule 1 – which includes UK EMIR – will be revoked and replaced by rules on the relevant regulatory authority's rulebooks.

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?

In February 2023, the FCA and Bank of England published new UK EMIR reporting rules, which broadly align with global guidelines on trade reporting for derivatives published by the Bank for International Settlements and the International Organization of Securities Commissions ("**IOSCO**"). These new rules contain a variety of changes, including technical updates where reports must now be made in an electronically machine-readable form, the introduction of new data fields and, in some circumstances, more frequent reporting requirements, such as margin updates requiring daily reports. The new UK EMIR reporting rules will apply from 30 September 2024. While these rules broadly align with the new EMIR reporting rules (which will apply from 29 April 2024), there are a few areas of divergence, which may lead to additional costs for market participants who are part of groups that operate in both the UK and EU.

It should be noted that EU rules on clearing, mandatory margining and trade reporting are currently being reviewed, and the EU Commission has published its legislation proposal, known as EMIR 3.0. Following Brexit, these amendments to

EMIR will not be automatically onshored in the UK. Therefore, subject to the UK authorities tracking the proposed amendments under EMIR 3.0, there is likely to be increasing divergence between the two regulations.

The UK authorities are also seeking to align the DTO under the UK MiFID II regime with the exemption for SFCs under UK EMIR. The Financial Services and Markets Bill 2022–23 (which, at the time of writing, is progressing through Parliament) will include adjustments to the DTO to exempt SFCs from clearing, in line with the SFC exemption from clearing under UK EMIR. Subject to parliamentary approval, the Financial Services and Markets Bill 2022–23 will also provide for an exemption from the DTO for post-trade risk reduction services (with a corresponding disapplication from the clearing obligation under UK EMIR) and give the FCA certain powers to suspend or modify the DTO permanently.

Finally, as of 1 September 2022, the UK EMIR requirement for mandatory IM exchange is fully phased in and now applies to users of derivatives that have an outstanding aggregate average notional amount ("**AANA**") of non-centrally cleared OTC derivatives transactions (in most cases on a group-wide basis) above EUR 8 billion. Much has been written about this subject and the authors can provide detailed advice for individual clients upon request.

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 as defined in the RAO and require, as part of their "Part IVA permission", permission for each type of specified activity they propose carrying on. Credit institutions and the largest investment banks will be prudentially regulated by the 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 should reflect this, appears on the Financial Services Register maintained by the FCA (this includes the permissions for banks and large investment firms that are prudentially regulated by the PRA). The Financial Services Register is likely to show that the firm has permission to deal as principal in relation to all three types of derivatives for regulatory purposes – i.e. options, futures and contracts for differences (with some subdivisions for, e.g. commodity derivatives, spread bets and rolling spot forex contracts).

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)?

Certain occupational pension schemes benefit from an exemption from the clearing obligation under UK EMIR, which is time limited and is currently due to expire on 18 June 2025. This exemption applies to both UK and EEA pension schemes (although, in practice, most EEA pension schemes are likely to clear transactions as the equivalent EMIR exemption expires on 18 June 2023).

There are also separate exemptions from the reporting, clearing and margin obligations under both EMIR and UK EMIR for intra-group derivatives transactions, provided that certain criteria are met. The criteria for meeting these exemptions differ between entity classifications, vary between the three types of exemptions, and may require counterparties to submit applications to the relevant NCA. A detailed explanation of the required criteria is beyond the scope of this publication.

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 is dissolved, becomes insolvent or unable to pay its debts, or faces a resolution for its winding-up or liquidation.

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.

A new, free-standing moratorium procedure was introduced in 2020. The aim of the moratorium is to provide companies in financial distress with breathing space to achieve a restructuring or turnaround plan. The moratorium is available to eligible companies for an initial period of 20 business days, which can be extended. During the moratorium period, the company has a moratorium from enforcement from both secured and unsecured creditors and remains in the control of its directors under the supervision of a monitor. The company must still pay certain types of debts that fall due before and during the moratorium period. This includes amounts falling due under contracts or other instruments involving financial services (which includes loan agreements, swaps, futures and other derivatives transactions). Therefore, the moratorium procedure would not impact on the liability of the counterparty to pay close-out amounts. However, subject to the exemption for financial collateral referred to below, security cannot be enforced during a moratorium without court permission.

Not all companies are eligible for a moratorium procedure. Companies that are not eligible include insurance companies, banks, electronic money institutions, investment banks and firms, and parties to capital market contracts and charges, participants in designated systems, payment institutions, operators of payment systems, infrastructure providers, investment exchanges, securitisation companies and parties to capital market arrangements, recognised investment exchanges, recognised clearing houses and recognised CSDs (Central Securities Depositories) within the meaning of FSMA.

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; and

(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.

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, FSMA and the Banking Act 2009 continue to operate to enable the regulators of 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 that 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 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. For transactions at an undervalue entered into with the substantial purpose of defrauding creditors, inability to pay debts at the time of the transaction is not a requirement.

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) that 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 published on 21 September 2022.

Broadly, under English law, the netting provisions contained in the ISDA Master Agreement are valid and enforceable in circumstances where neither counterparty is subject to insolvency proceedings. Equally, although there are several different types 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 insolvency scenarios, the provisions in the ISDA Master Agreement would normally need to be considered in the light of, among other things, the anti-deprivation principle, the *pari passu* rule and the insolvency set-off rules.

However, the English law 1992 and 2002 ISDA Master Agreements both contain a "single agreement" clause with the effect that all transactions made under it are treated as giving rise to a single amount payable in the event of a close-out. The effect of this is that we do not normally need to consider the rules that apply to setting off an insolvency as the single amount is provable debt.

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; 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 close-out netting in respect of all derivatives transactions under a single master agreement, including in the event of an early termination of transactions?

Restrictions on close-out netting in respect of derivatives transactions under a single master agreement would generally only apply in very limited circumstances.

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.

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 Pound 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 derivatives 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 material considerations that should be considered by market participants wishing to enter into derivatives transactions in your jurisdiction? Please include any cross-border issues that apply when posting or receiving collateral with foreign counterparties (e.g. restrictions on foreign currencies) or restrictions on transferability (e.g. assignment and novation, including notice mechanics, timings, etc.).

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.

There are no general restrictions on the transferability of derivatives transactions; however, under English law, only the benefit of a contract can be assigned. Obligations under ISDA documents may only be transferred 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).

If parties wish to rely on the greater protection afforded to security-takers under the Financial Collateral Arrangements (No. 2) Regulations 2003, such as a right to appropriate collateral, they will need to ensure that the custody arrangements for the collateral satisfy tests for possession and control of the collateral being with the collateral-taker. In the case of regulatory IM, collateral-takers and providers need to ensure that transferred collateral is segregated from the proprietary assets of the collateral-taker so as to be available to the collateral-provider in the event of the collateral-taker's insolvency. These two requirements mean that custody arrangements can be complex and heavily negotiated.

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. In some cases, additional contractual arrangements are required to reflect updates to the parties' operational processes in line with the regulations (such as reporting, regulatory margin and portfolio reconciliation).

We have seen an increased number of publications being produced by ISDA to facilitate amendments by parties to their contractual arrangements, including in response to various recent regulatory and technological developments. This includes the 2021 ISDA Interest Rate Derivatives Definitions, which reflect such developments in market practice, and are expected to replace the 2006 ISDA Definitions (and associated supplements) as the standard definitions for interest rate derivatives.

Another key change in the derivatives market is the focus on sustainable finance in the face of increasing regulatory pressures and demand from investors to promote the incorporation of environmental, social and governance factors into investment strategies and the derivatives market. There has been a particular focus on derivatives in the carbon market, notably the trading of UK emission allowances under the UK Emissions Trading Scheme. More broadly, in October 2022, the FCA issued proposed rules to establish a UK sustainability disclosure regime, which are expected to be finalised by the end of Q2 2023, with manager- and product-level disclosure and reporting rules to be phased in from 2024.

8.2 What, if any, ongoing or upcoming legal, commercial or technological developments do you see as having the greatest impact on the market for derivatives transactions in your jurisdiction? For example, developments that might have an impact on commercial terms, the volume of trades and/or the main types of products traded, smart contracts or other technological solutions.

A key development is the increasing regulatory divergence after the withdrawal of the UK from the EU on 31 December 2020. Developments in the regulatory space no longer automatically align between the UK and EU, and the EU has not made equivalent decisions that would allow counterparties to meet UK regulatory requirements when conducting business in the EU without also having to meet EU requirements. As seen in the new EMIR/UK EMIR reporting requirements and EMIR 3.0 proposals (see question 3.2), there is scope for growing regulatory divergence. Market participants who are part of groups that operate in both the UK and EU may find themselves subject to both EMIR and UK EMIR requirements, particularly in respect of the trade reporting obligation, which may involve additional costs and operational burdens.

The developments in cryptocurrency continue to have a significant impact on the derivatives market. The collapse of FTX (a high-profile crypto exchange platform) prompted further regulatory scrutiny of the global crypto market. The FCA is leading the crypto and digital assets workstreams within the IOSCO Fintech Task Force and is working with the UK government to introduce regulation of the wider cryptoassets industry.

There has also been 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, and ISDA has set up various initiatives and published guidelines to facilitate the use of smart contracts. See chapter 1 of this *Guide* for further details on how the use of smart contracts and the implementation of digital asset referencing derivatives are currently reshaping the derivatives industry.

Finally, the sanctions and financial restrictions on Russia, further to the ongoing Russia-Ukraine conflict, have triggered significant and far-reaching market disruption. ISDA and other industry bodies have published amendment agreements and template provisions to mitigate potentially increased counterparty risk as a result of the ongoing conflict, and there may be further developments.

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/UK EMIR and SFTR/UK 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. Jonathan was recognised in the latest edition of *The Legal 500* as a "Leading Individual" in derivatives and structured products.

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