

ISDA future-proofs arrangements against uncertainties posed by Brexit

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Banking & Finance analysis: Judith Lawless, partner at McCann FitzGerald in Dublin, explains how the International Swaps and Derivatives Association's (ISDA) publication of Irish and French law governed credit support documents is part of a broader ISDA initiative responding to member demand for documentation governed by the laws of an EU Member State.

Why did ISDA publish credit support documents governed by Irish and French law?

ISDA's publication of Irish and French law governed credit support documents is part of a broader ISDA initiative responding to member demand for documentation governed by the laws of a Member State, with a related election for the courts of that Member State to have jurisdiction in related disputes, to future-proof their arrangements against the uncertainties posed by Brexit. The initial step was taken in June 2018, when ISDA published Irish and French law governed versions of its 2002 Master Agreement. Given that many derivative market participants are subject to regulatory margin requirements and, of those that are not, many choose to margin for risk management purposes, ISDA's publication of credit support documents for use in connection with the new Master Agreements was a natural next step.

ISDA members had identified a number of benefits that would flow from the availability of such documents. The principal benefit is, of course, the EU's highly flexible [Council Regulation \(EC\) 1215/2012](#) (Brussels Regulation Recast) regime for the recognition and enforcement throughout the EU of judgments obtained in a Member State. It remains unclear whether judgments obtained in the UK post-Brexit will continue to benefit from automatic recognition throughout the EU as they do now, particularly after any agreed transition period expires. Even if, as proposed by the UK government, the UK independently participates as a contracting state in the Convention of 30 June 2005 on Choice of Court Agreements (Hague Convention), such participation will not resolve all concerns in this regard. Whereas Member States are contracting states to the Hague Convention, which requires effect to be given in contracting states both to in scope choice of court agreements designating the courts of a contracting state and to the judgments of the designated courts, the Hague Convention is subject to some important limitations including that it will have no effect in respect of an English law governed ISDA document that incorporates either a non-exclusive jurisdiction clause or an exclusive jurisdiction clause entered into while the UK is not a contracting state.

Of course, this is not to suggest that judgments from UK courts will not be enforceable post-Brexit as a matter of the domestic law Member States. Indeed, foreign judgments from non-EU Member States (eg those from the courts of the State of New York) are currently enforceable as a matter of domestic law in certain Member States (including Ireland, subject to certain conditions), notwithstanding that there is no formal reciprocal enforcement regime in place. However, the existing Brussels Regulation Recast regime for the recognition and enforcement of Member State judgments across the EU is a huge benefit to judgment creditors—from the perspective of certainty, reduction in costs and elimination of delays—and loss of the convenience of that regime was a significant driver of the ISDA project.

Two other factors of relevance to the ISDA initiative were as follows.

Concerns deriving from Article 55 of the EU Bank Recovery and Resolution Directive 2014/59/EU

Article 55 of the EU Bank Recovery and Resolution [Directive 2014/59/EU](#) (BRRD) requires EU banks and other in scope entities to include a contractual recognition of BRRD's bail-in provisions in a very wide range of non-EU law governed contracts. Of course, this currently arises in respect of New York law governed ISDA documents and in scope entities deal with it when transacting under such documents by including appropriate contractual provisions. However, the BRRD regulatory fitness and performance review process focused affected market participants on the vulnerability of these contractual fixes to legal change and the benefits of contracting under documentation governed by the laws of a Member State.

Concerns deriving from Article 46(6) of Regulation (EU) No 600/2014

[Article 46\(6\)](#) of Regulation (EU) No 600/2014 (MiFIR) requires in scope non-EU entities providing investment services or performing investment activity within the EU to offer to submit any disputes relating to those services or activities to the jurisdiction of a court or an arbitral tribunal in a Member State. Such investment services and investment activity may, of course, encompass the transaction of derivatives under ISDA documentation.

How are they similar to, and different from, the English law credit support annex?

The Irish and French law governed documents that ISDA has published are based on its 2002 Master Agreement (the original of which provides for an election between English and New York law) and the English law governed 1995 Credit Support Annex (Bilateral Form—Transfer) (1995 Annex) and 2016 Credit Support Annex for Variation Margin (VM) (Bilateral Form—Transfer) (2016 VM Annex).

In the case of the Irish law versions, minimal changes have been made which are limited, in the case of the Master Agreement, to:

- amending the governing law provision to designate Irish law as the applicable governing law and, reflecting the approach taken in the model governing law clause set out in the 2018 ISDA Choice of Court and Governing Law Guide, published for use in connection with ISDA Master Agreements governed by English and New York law (2018 Guide), providing that related non-contractual obligations will also be governed by and construed in accordance with Irish law
- replacing the jurisdiction provision with alternative provisions for the submission to the exclusive, or non-exclusive, jurisdiction of the Irish courts, with a fall back to 'exclusive jurisdiction' if the parties fail to designate either as applicable (the alternative exclusive and non-exclusive jurisdiction provisions reflect the substance of the 2018 Guide's model exclusive jurisdiction clause and model non-exclusive jurisdiction clause, respectively)
- deleting the definition of 'Convention Court,' in a related amendment, which is redundant in the Irish law Master Agreement
- replacing the definition of 'English law'/'English' with a definition of 'Irish law'/'Irish'
- amending the definition of 'Termination Currency' to provide for the fall back termination currency to be euro (as it is where the 2002 Master Agreement is governed by English law)
- identifying in the header that the document is governed by Irish law

Even fewer changes have been made to Irish law versions of the 1995 Annex and 2016 VM Annex, being limited to:

- changes to the header and footer to identify the document as governed by Irish law and for use with an Irish law governed ISDA Master Agreement
- as the Irish law version of the 1995 Annex is intended for use solely in conjunction with the ISDA 2002 Master Agreement (Irish Law), whereas the English law version was prepared for use with, and incorporates terms used in, the 1992 ISDA Master Agreement, the amendments designed by ISDA to adapt that English law version for use with a 2002 ISDA Master Agreement (set out in ISDA 2002 Master Agreement Protocol), have been incorporated
- as the Irish law version of the 2016 VM Annex is intended for use solely in conjunction with the ISDA 2002 Master Agreement (Irish Law), provisions included in the English law version of the 2016 VM Annex that are specific to the 1992 ISDA Master Agreement have been deleted
- an EU legislative reference contained in the elections and variables section of the 2016 VM Annex has been updated

Whereas equivalent changes have been made to the French law governed documents (subject to some technical differences such as providing that the submission to the exclusive or non-exclusive jurisdiction of the French courts in the Master Agreement is to specific such courts, being the special chambers for international business disputes of the Commercial Court of Paris and Paris Court of Appeal, and the designation of the law governing, and choice of courts for disputes in respect of, non-contractual obligations is provided as an optional election in the Schedule to the Master Agreement), additional technical changes have been made to the French law documents to conform them to French law concepts and requirements.

Do these credit support documents assist with facilitating compliance of regulatory initial margin regimes?

Having consulted with members, ISDA has at this stage chosen not to publish Irish or French law governed credit support documents to facilitate compliance with regulatory initial margin regimes, pending expressions of interest from members in such documents. As the law governing such documents tends to be that of the jurisdiction in which the relevant custodian is located, rather than the law governing the related master agreement, whether such documents are in due course published by ISDA will likely depend on whether parties subject to such regimes choose custodians in Ireland and France to provide the custodial services supporting such arrangements.

It should, however, be noted that, in the context of its work on initial margin documentation for Phases 4 and 5, it is anticipated that ISDA will produce separate documentation relating to the obligation to provide initial margin and mechanical aspects of the parties' relationship in respect thereof (a collateral transfer agreement to be governed by the governing law of the Master Agreement) as well as the grant and enforcement of security over the segregated account (a security agreement to be governed by the law of the place of the account, which may differ from the governing law of the Master Agreement)

ISDA has been working with counsel in England, New York, France and Ireland to ensure that the collateral transfer agreements will work effectively regardless of whether the governing law of the Master Agreement is English, New York, French or Irish law.

What will be ISDA's next step?

An updated French collateral provider insolvency opinion, and a supplement to the recently issued Irish collateral provider insolvency opinion, was issued on 20 December 2018, encompassing the French and Irish credit support documents, respectively. ISDA will now extend the ambit of its collateral opinion exercise so that collateral opinions, and opinion updates, commissioned after publication of the French and Irish law governed credit support documents encompass those documents. Since the publication of the Irish and French law versions of its 2002 Master Agreement, ISDA has been working on extending the jurisdictional netting opinion coverage to encompass the French and Irish law governed Master Agreements and plans to continue to do so.

As regards further steps I have encountered member interest in extending existing principal-to-principal clearing documentation and related opinion coverage to encompass Irish law governed ISDA Master Agreements and credit support documents. However, member demand will ultimately drive any further steps that ISDA may take.

What has the market's reaction been to this publication?

The market's reaction has been very positive, which is unsurprising given that the documentation was published by ISDA in response to member demand. Given that, as already mentioned, over-the-counter (OTC) derivatives are increasingly transacted on a collateralised basis—whether for regulatory compliance and/or risk management reasons—the availability of these new credit support documents to support the existing French and Irish law ISDA 2002 Master Agreements will enhance the popularity of the Irish and French law governed ISDA 2002 Master Agreements as documents of choice within the EU. As regards the Irish law governed documentation, in a post-Brexit environment, where Ireland will be the largest common law jurisdiction in the EU and judgments of Member State courts benefit from automatic recognition and enforcement throughout the EU, ISDA's initiative will be a significant benefit to users of ISDA documentation. The very limited differences between the existing English law, and new Irish law, versions, and the similarities that exist between English and Irish contract law and legal systems, will be viewed as points of strength and reassurance by those users.

Judith is an expert in OTC and exchange-traded derivatives and related collateral arrangements, advising buy and sell side market participants and market infrastructure providers on trading, clearing, settlement, custody and the regulatory environment in which it takes place. Her transactional and advisory practices are complemented by her role as counsel to ISDA in respect of the legal opinions made available by it to its members as to matters of Irish law. Judith has been to the forefront of Irish financial industry innovations throughout her career and was delighted to work with ISDA on its project to make available documentation governed by Irish and French law and on the legal opinions

supporting the Irish law governed documentation. More generally, Judith has broad experience in financial and treasury services and structured finance, advising on related transactional and regulatory issues.

Interviewed by Kate Beaumont.

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