

## **Global Derivatives Business Issues**

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**Global Derivatives Business Issues**  
**10:00 AM, Thursday, April 14<sup>th</sup>**

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## **Market Structure**

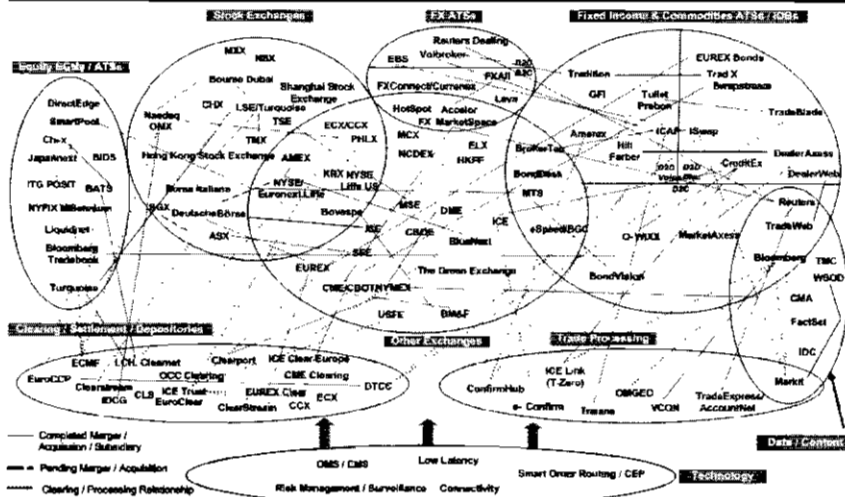
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**Market Structure: The configuration of people, companies, and technology that provide access to data and financial markets**

- The components of market structure, whether based on people or technology, serve as intermediaries between end users and financial products
- We can consider market structure in various ways
  - Functionally: Pre-Trade, Trade Execution and Post-Trade
  - Asset Class: Commodities, Credit, Equities, FX, Rates
  - Product Type: Listed vs. Over The Counter (OTC), Standardized vs. Customized
  - Medium: Voice vs. Electronic
- Market Structure is highly dynamic and interconnected

# Current Landscape

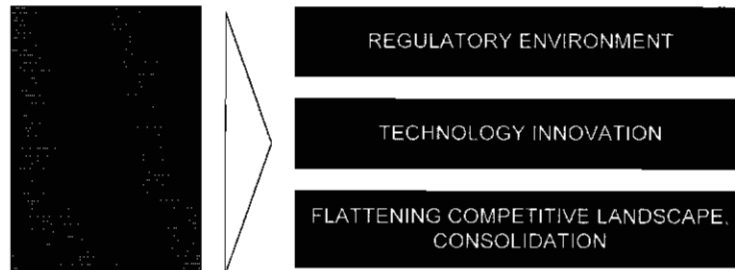
## Highly Dynamic and Interconnected



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# Changes and Challenges



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## Global Public Policy Developments - Japan

**Atsushi Takahashi**  
President & CEO  
Mizuho Alternative Investments, LLC

**ISDA 26<sup>th</sup> Annual General Meeting  
Global Public Policy Developments  
4:00 PM, Thursday, April 14, 2011**

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### 1. Regulatory Requirements (Japan, US and EU) Overview

	JAPAN	US	EU
<b>Products</b>	•Interest Rate Swap (only Plain Vanilla Swap ) •CDS (only iTraxx Japan)	•Wide Range of OTC Derivatives except FX Spot	•Wide Range of OTC Derivatives •FX Spot/Forward?
<b>Swap Execution Facility</b>	Under Discussion	○	Under Discussion
<b>Clearing</b>	○	○	○
<b>Trade Repository</b>	○	○	○
<b>Non-Cleared Trades</b>	NA (Announced after Basel III?)	○	○
<b>Effective</b>	November 2012 at the Latest	July 2011 at the Latest	July 2012 at the Earliest

## 2. More Details About Japanese Regulatory Requirements

JAPAN			
	IRS	CDS (iTraxx Japan)	Commodity
Clearing	<b>【TSE/JSCC】</b> • Target launch: Not yet fixed • Standalone CCP or/and Linkage with overseas CCP	<b>【TSE/JSCC】</b> • Target launch: July 2011 • Standalone CCP • Final preparation is ongoing	• The regulation is not prescriptive • Major players use the international CCPs
Trade Repository	Waiting for international consensus	<b>【DTCC】</b> • Most of users use The Warehouse Trust Company	Waiting for international consensus

## 3. Other Items To Be Discussed?

### ■ Regional reference/Harmonization

### ■ Links between CCPs

“In order to minimize systemic risk, under no circumstances shall a derivatives clearing organization be compelled to accept the counterparty credit risk of another clearing organization.”

--- Wall Street Transparency and Accountability Act of 2010 , §725

“[...], it is appropriate at this stage to restrict the scope of interoperability arrangements to cash securities. However, by 30 September 2014, ESMA should submit a report to the Commission on whether an extension of that scope to other financial instruments would be appropriate.

--- European Commission Proposal for a Regulation of the European Parliament And of the Council on OTC derivatives, central counterparties and trade repositories (42)

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## Recent Developments in China Derivatives Market

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Global Public Policy Developments  
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## New Derivatives Measures for Banking Financial Institutions

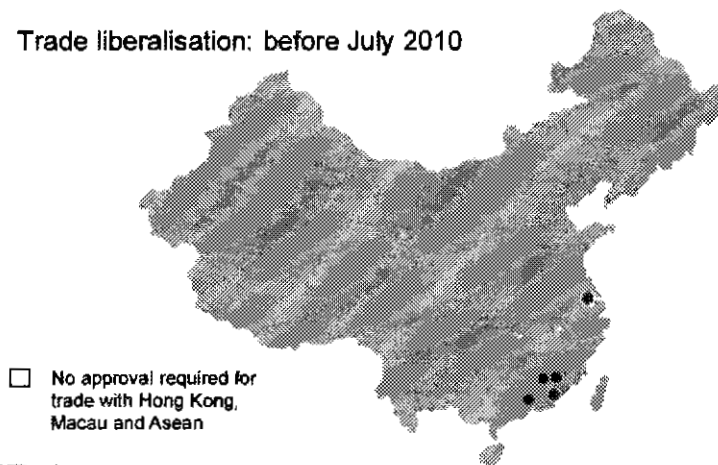
- > Effective 5<sup>th</sup> January 2011 – replaced the 2004 Derivatives Measures for banking financial institutions
- > Two-tiered qualifications (only single qualification under 2004 Derivatives Measures)
  - > Basic qualification v. general qualification
  - > Hedging transaction (asset/liability risk management) v. non-hedging transactions (client motivated trades, market making and proprietary trades)
- > Transitional period: 30 June 2011 (existing license holders under 2004 Derivatives Measures grandfathered and converted to general qualification)
- > Notable Restrictions:
  - > CBRC may impose certain restrictions even if banks hold general qualification
  - > For non-hedging transactions - market risk capital  $\leq$  3% of the core capital
  - > Other prohibited restrictions: (1) naked short position exposed to unlimited loss and (2) derivatives over derivatives

## China launched Interbank Credit Derivatives Market

- > NAFMI published on 29 Oct 2010 the Guidelines for Interbank Market Credit Risk Mitigation Instruments (Pilot Scheme)
- > "Credit Risk Mitigation Instruments" and there are two types:
  - > CRM Contract
  - > CRM Warrants
- > Market participants categorised into Non-Dealers, Dealers and Primary Dealers
- > Restrictions on CRM Instruments under the Guidelines
  - > "Simple and basic"
  - > "Reference Obligation Only"
  - > Reference Obligation refers to specific "bonds or other similar debts"
  - > No "self-referenced" credit derivatives
  - > Position limits
- > Still early stage but as of 4<sup>th</sup> April 2011, 23 CRM Contracts registered and 9 CRM Warrants issued
- > CBRC Derivatives Measures - any restriction for use of credit derivatives by banks? 2

## The internationalisation of RMB

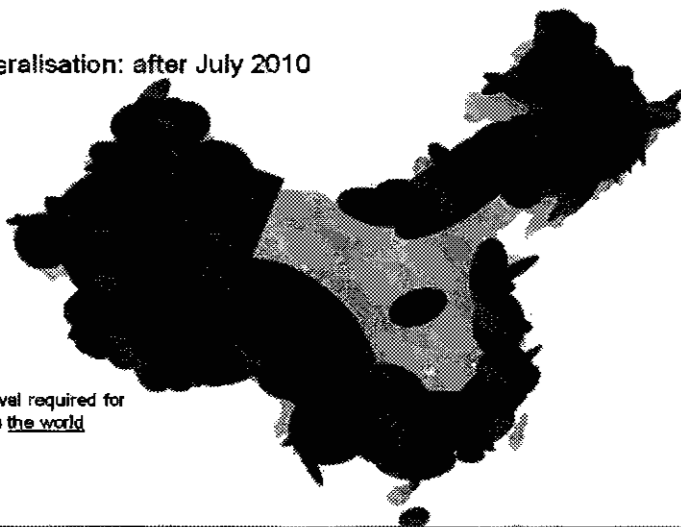
Trade liberalisation: before July 2010



## The internationalisation of RMB

Trade liberalisation: after July 2010

■ No approval required for trade with the world



## The internationalisation of RMB (CNY)

- > RMB liberalisation currently means no China prohibitions on:
  - > Offshore RMB dealings outside Mainland; or
  - > RMB for trade settlement (or current account) across the boarder (note approval still required for capital account purposes).
- > The "explosion" of offshore RMB (CNY) products – "Dim Sum" bonds, deposits including CDs, loans, IPOs and derivatives (including physically settled RMB forwards, swaps and options as well as RMB denominated structured deposits and structured notes).
- > RMB (CNY) which is a not freely convertible currency being dealt with offshore as though it were freely convertible.
- > Emergence of Hong Kong as "offshore RMB centre" - CNH (CNY deliverable in Hong Kong) with Hong Kong conventions including payment into an account in Hong Kong, business day in Hong Kong etc.
- > Developing market practice including disruption events (Disruption Events 1998 FX and Currency Options do not contemplate offshore currency such as offshore RMB (CNY))
- > Article VIII(2)(b) of the IMF Agreement not an issue : expressly contemplated by Chinese regulations
- > Further (and gradual) liberalisation of capital account in the pipeline....



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## Other Developments

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- > Enforceability of close-out netting and collateral for derivatives
  - > Still unclear (no change in the last 12 months) but keen awareness among regulators and courts
- > G20 commitment for clearing of OTC derivatives
  - > Potentially by Shanghai Clearing House (established 28 Nov 2009, currently handling registration and settlement for CRM Warrants)
- > Regulatory efforts are directed at opening up/liberalising the currency and developing onshore derivatives markets including new products (albeit cautiously)

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## Recent Developments in China Derivatives Market

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## Indian Derivatives Market

**Shilpa Kumar**  
Senior General Manager, Head of Global Markets  
ICICI Bank

**Global Public Policy Developments**  
4:00 PM, Thursday, April 14, 2011

### Agenda

**Indian derivatives market - An overview**

**State of the market and recent developments**

## **Agenda**

**Indian derivatives market - An overview**

**State of the market and recent developments**

 **ICICI Bank**

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## **Indian derivative market - An overview**

- **High economic growth post liberalization in 1991**
  - **Dismantling of trade barriers – benefiting from increased exports/cheaper imports**
  - **Opening up of economy to capital flows – access to cheaper finance**
  
- **Parallel growth in financial markets across fx, bonds, equity and derivatives**

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## **Agenda**

**Indian derivatives market - An overview**

**State of the market and recent developments**



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## **Derivative markets - An overview**

- **Pre 1991: Simple and restricted foreign exchange forward contract**
- **Post 1991**
  - **1992: Freeing of conventional forward contract**
  - **1994: Introduction of cross currency options**
  - **1997: Introduction of currency rupee swaps**
  - **1999: Introduction of interest rate swaps (IRS, FRAs)**
  - **2003: Introduction of currency rupee options**
  - **2008: Introduction of currency futures**
- **All OTC derivatives: under the purview of RBI**



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## Financial infrastructure development keeping pace

- **Forex**
  - Guaranteed settlement through CCIL for USD/INR spots and forwards
- **Corporate Bonds**
  - Mandatory reporting
  - Introduction of repo
- **Rupee interest rates**
  - STRIPS, short-selling of interest rate futures
  - Centralized reporting, clearing and settlement of inter-bank trades through CCIL



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## Launch of exchange traded products

- **Recognized stock exchanges in the country permitted to deal in exchange traded currency products**
- **Products launched**
  - 2008: Currency futures in USD/INR
  - 2009: Interest rate futures (10-year notional G-Sec)
  - H1-2010: Currency futures in EUR/INR, GBP/INR, JPY/INR
  - H2-2010: Introduction of currency options
- **All exchange traded derivatives under the purview of SEBI and RBI**



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## Recent developments - OTC Fx / IRS\*

- **Increased emphasis on hedging**
  - Availability of underlying made mandatory
  - Trade cancellation, if delay in receiving documents
  - Significant information disclosure from both parties
- **Moving to vanilla**
  - Leveraged structures, digital options, barrier options, range accruals, exotic products not permitted
- **Eligible entities**
  - Cost reduction structures only by AS30/32 corporates
  - Minimum net worth criteria for certain products
  - Board approval for risk management policy

\* Effective from February 1, 2011



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## Credit market characteristics

- Smaller market size relative to G-Secs
- Supply dominated by quasi-sovereign issuers
- Typically AAA or AA+ rated issuances
- Preference for private placements over public issues - primarily an institutional investor market
- Largely rated & listed on local stock exchanges
- Key regulatory initiatives undertaken in last one year to improve the breadth & depth of market



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## **Credit markets – key trends**

- **Emphasis on ensuring domestic funding through domestic corporate bond market**
- **Issuers largely dominated by public sector entities, banks and financial institutions**
- **Investments driven primarily by regulatory guidelines and liquidity needs**
  - **Large investors include insurance companies, provident funds and few bank treasuries**



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## **Key regulatory initiatives – products**

- **Product related**
  - **Standardisation of bond characteristics**
  - **Repo in corporate bonds allowed**
  - **FII investment limits enhanced to USD 40 bn**
    - **Emphasis on long tenor infrastructure bonds**
  - **Proposed changes to PF guidelines – greater allocation to corporate bonds**



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## **Credit markets – key regulatory initiatives**

- **Infrastructure related**
  - **Mandatory reporting of all OTC trades**
  - **Clearing & settlement through exchange platforms**
- **Process related**
  - **Disclosure requirement simplified for listed entities**
  - **Allotment method done away with for long tenor infra investment limits for FII clients**



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## **Draft guidelines on rupee CDS**

- **Separate categories of participants**
  - **Users: permitted to both buy & sell protection**
  - **Market-makers: not permitted to sell protection, but only to hedge the underlying risk by buying CDS**
- **Single name CDS only allowed**
  - **Rupee corporate bonds as underlying, not loans**
- **'Restructuring' not permitted as credit event**
- **FIIs allowed to participate as 'users'**
- **Mandatory reporting of CDS trades**



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## Subsidiarization of foreign banks

- Draft note issued on January 21, 2011
- Covering following areas:
  - Benefits of branch presence compared to subsidiary presence
  - Delineation between parent and subsidiary
  - Applicability of local laws
  - Control in event of banking crises
- Subsidiary form of presence preferred over branch form



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## Secondary market volumes

( ₹ billion)

Year	FY2009	FY2010	FY2011
Corporate bonds	1,482	4,012	6,053
G-Secs	21,602	29,155	28,671

Source: SEBI, CCIL;



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## Expiration of Kyoto Protocol & Shutdown of EU Carbon Registries

**Rachel Caffarate**  
Vice President, Legal Department  
Barclays Capital

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### Kyoto Protocol

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- **Kyoto Protocol** is the internationally binding agreement to establish binding commitments for the reduction of greenhouse gas (GHG) produced by Annex 1 nations
- How implemented?
  - Emissions Trading with **EU Emissions Trading Scheme** (Cap & Trade) being most advanced & only major player in the market
  - Clean Development Mechanism
  - Joint Implementation
- First Commitment Period ends in 2012
- Currently no successor/extension to Kyoto



## How does this impact on EU ETS post 2012

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### Impact on EU ETS?

- EU ETS (from 2005) predated Kyoto. It is currently in its Phase 2 (2008-2012) and is set to continue into Phase 3 (2013-2020) even in absence of similar multilateral regime binding other countries
- Most emission allowances and credits (EU Allowance/Kyoto Units) trade on bilateral OTC basis. Documentation: **ISDA Master Agreement inc. EU Emissions Allowance Transactions Annex (Feb 2008: Phase 2)**
- **BUT what about Phase 3 Trading?**  
Currently no industry standard emissions documentation to allow for Phase 3 EU Allowance or Kyoto Unit trading



### WHY? Challenging Legal Environment

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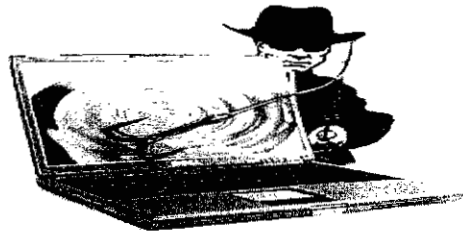
- **Phase 3 EU Allowances = non-Kyoto Units.** ISDA/IETA/EFET on-going efforts to modify existing documentation for EUA trading in the EU ETS
- **CER trading in EU ETS Phase 3? Yes BUT...** Documentation to balance commercial marketability of contract AND protection of risks from uncertainty of:
  - (1) rules for exchanging CERs for EUAs and when exchange can occur
  - (2) what project specific CERs will be eligible from 1 Jan 2013
  - (3) whether will (and if so, when) there be a multiplier applied to compliance use of CERs from certain industrial gases? (TO DATE: CER = EUA = right to emit 1 tonne emissions)
- If EUAs and CERs no longer fungible: pricing considerations

## Phishing /Cyber Theft from EU National Registries

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### BACKGROUND

- EUAs and CERs are held and traded in national registries of each individual Member State
- Some registries have historically had weak or no on-boarding requirements
- Many registries have had minimal security controls
- Many corporates will not check their accounts regularly, even with recent publicity
- Risk of Phishing/ cyber thefts
- Stolen certificates are in circulation leading to a lack of confidence in the market
- EC shut down all registries at end Jan 2011 after series of phishing/cyber thefts from certain national registries
- Exchanges stopped spot trading



## Restoring confidence & liquidity in EU ETS...

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- Market participants, through no fault of their own, hold (and need to ensure that they do not hold in the future) potentially stolen allowances.
- Potential exposure to monetary loss and/or criminal/civil law sanctions
- Need to prevent/mitigate receipt of allegedly stolen allowances
- **Proposed measures to EC (IETA/market participants):**
  - (1) enhanced IT security measures across all Member States National Registries
  - (2) enhanced notification and intervention by national authorities
  - (3) improved KYC on new/existing accounts
  - (4) ongoing monitoring of registries and transactions
  - (5) delay transfers; restrict volumes
  - (6) restrict access to the market (MiFID regulated firms and compliance buyers?) or different account categories
  - (7) published central list of stolen allowances
  - (8) long term regulation...MiFID

## Legal conundrum...

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- Unclear legal status of an allowance (E.g. licence/property rights?)
- How establish good title? Different rules in Member States (England: if stolen, no good title regardless of bona fide purchaser for value ("Nemo dat" rule))
- Which law applies?
- Need for harmonisation EC-wide to facilitate taking ownership and trading allowances in good faith

Longer term reform issues....

## Contractual certainty

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- ISDA/EFET/IETA Working Groups consolidated effort to co-ordinate standard terms in trade documentation to address circumstances where "stolen" allowances have been delivered to a Receiving Party
- Issues:
  - (1) What is stolen allowance? Is it sufficient that an allowance is alleged stolen?
  - (2) Title warranties
  - (3) Longstop date after which a Receiving Party can no longer have recourse to Delivering Party?
  - (4) What recourse? Return & replace allowances (if legally possible)/Replacement Costs



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## **ISDA involvement in the Czech Republic: all positive**

**Radek Urban**  
CFO  
Ceska sporitelna/ISCS

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### **The “old days”**

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- Late eighties, early nineties: banks/brokers use their own agreements
- ISDA as the leading trade association
- The 1992 Master Agreement
- The CZK convertibility
- The need for local master agreement



## The “new days”

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- Capital market Act: close-out netting
- The new Financial Collateral Act implements the EU Collateral Directive
- The new Civil Code
  
- The acid test: the difference between close-out netting and set-off

## Lessons learnt

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“The road is as important as the destination.”

(Jeff Golden)

## **Update on Emerging Market Jurisdictions in Europe, Middle East and Africa**

**Peter Werner**  
Senior Director  
ISDA

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## **Emerging Markets Law Reform: Focus**

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- General enforceability of derivatives contracts
- Netting
- Collateral/intermediated securities
- Cross-border insolvency and financial firm resolution
- Private international law
- Dispute resolution

# ISDA netting legislation initiatives

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- ISDA promotion of netting legislation since 1987 in various jurisdictions/2006 ISDA Model Netting Act
- “*Status of Netting Legislation*” monitor on the ISDA website at: [http://www.isda.org/docproj/stat\\_of\\_net\\_leg.html](http://www.isda.org/docproj/stat_of_net_leg.html)
- *Current initiatives in:*
  - CEE: Poland, Bulgaria, Czech Republic, Slovakia, Hungary, Romania
  - SEE: Slovenia, Croatia, Serbia
  - CIS: Russia, Kazakhstan, Ukraine
  - Middle East: UAE, Bahrain, Qatar, Saudi Arabia, Pakistan
  - Africa: Nigeria, Mauritius, South Africa, Egypt, Morocco
  - Regional/global level – EU, FSB/G20, UNCITRAL, UNIDROIT, World Bank

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# Proposal to UNIDROIT for a netting convention

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- ISDA proposal in 2008
- Proposal: development of an international convention on close-out netting
  - Core rules for netting and related issues
  - Should not be limited to derivatives but should cover financial exposures more broadly (for example, spot forex, securities trading and so on)
  - Potential benefits:
    - common set of international norms for netting
    - Increase number of countries where netting works
    - Extend benefits of netting to emerging markets
    - Create a level playing field
    - Improve financial market efficiency and reduce system risk
- Importance of coordination with regional efforts, such as the proposal for a European netting instrument as well as proposed European bank recovery and resolution regime
- Adopted by Member States for Work Programme 2011-2013
- First meeting of Study Group scheduled for 18 April 2011
- Cross-border harmonization of special resolution regimes

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## Proposal for a European instrument on close-out netting

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- ISDA's on-going dialogue with European Commission on desirability of Europe-wide strengthening of netting
- Contractual Netting Directive (1994) and Financial Collateral Arrangements Directive (2002) dealt with netting but did not set out core principles
- ISDA proposal (2004) to the Commission's Securities Experts Group for a European instrument on close-out netting
- Joint proposal of ISDA and the European Financial Markets Lawyers Group (EFMLG) setting out proposed instrument in outline (2008)
- Idea given renewed impetus by financial crisis and support of G20, Basel Committee, Financial Stability Board and Commission itself in reports on financial crisis in 2009-2011
- **Objectives:**
  - To strengthen legal certainty by **promoting convergence** of the current member state netting regimes, which vary considerably in scope and content
  - To provide guidance by **setting out core principles** for member states without recognised netting regimes (Bulgaria, Estonia, Latvia and Lithuania) or where there are gaps or issues (various member states)

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## Current Commission work on netting proposal

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- Proposal currently being developed by the Commission's Internal Market DG
- Informal consultation with industry and legal experts
- Member State consultations in Dec 2010, Jan 2011, 12 April 2011
- Legislative proposal anticipated for July (or Sep) 2011
- Overlap with EU consultation on cross-border financial firm resolution
  - Proposal for temporary stay on early termination in connection with exercise of transfer powers

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## European consultations on cross-border crisis management in the financial sector

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- The EU has taken numerous steps to address the financial crisis, including proposing legal and regulatory reforms
- Commission Communications
  - An EU Framework for Cross-Border Crisis Management in the Banking Sector
  - Issued October 2009
  - ISDA response at [http://ec.europa.eu/internal\\_market/bank/crisis\\_management/index\\_en.htm](http://ec.europa.eu/internal_market/bank/crisis_management/index_en.htm)
- Commission response report
  - Issued 11 March 2010
- Conference “*Building a Crisis Management Framework for the Internal Market*” in Brussels on 19 March 2010
- Communication on a new EU framework for crisis management in the financial sector (20 October 2010)
- Consultation on technical details of a possible European crisis management framework (6 January 2011)
  - ISDA response: [http://www.isda.org/speeches/pdf/EU\\_CrossBorderCrisisMgmt\\_ISDAResponse\\_Mar11.pdf](http://www.isda.org/speeches/pdf/EU_CrossBorderCrisisMgmt_ISDAResponse_Mar11.pdf)
  - Commission intends to publish legislative proposal before Summer 2011

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## ISDA response to Commission consultations

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- Continuing importance of credit risk mitigation techniques such as netting, set-off, title transfer collateral, security
- Balancing government power and flexibility with legal certainty and respect for private law contract and property rights
- Need for safeguard in relation to resolution powers, such as a partial property transfer power, to protect:
  - netting, set-off, title transfer collateral, security
  - financial market infrastructure, including clearing and settlement functions
- Need for safeguard in relation to continuity powers, including strict limit in time and effect of suspension of right to terminate transactions
- Need to resolve existing issues of legal uncertainty in European legislation (across FCAD, WUD, SFD, Insolvency Regulation)
- Need to strengthen close-out netting in European financial markets to reduce systemic risk (specific EU instrument on netting)
- Need to address the difficult issues of “foreign property” in a national resolution and applicable law; effects on non-EU jurisdictions
- Special consideration of debt write-down (bail-in) resolution tool and power

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## Basel Committee on Banking Supervision Financial Stability Board

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- Report and Recommendations of the Cross-Border Bank Resolution Group (CBRG)
  - consultative document issued September 2009, for comment by 31 December 2009
  - Final report published on 18 March 2010
  - Conducted partly in parallel to equivalent EU consultation
  - Strengthening national resolution powers and their cross-border implementation
  - Firm-specific contingency planning
  - Reducing contagion
  - Strongly supports close-out netting and collateral and strengthening related legal framework
  - <http://www.isda.org/speeches/pdf/BCBS-CBRG-ISDA-response.pdf>
- Latest consultation by the CBRG under way (partly in co-op w/FSB)
  - An increased focus on the concept of “bail-in”

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## For further information

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For further information about the work of the ISDA Financial Law Reform Committee and the ISDA CEE/EMEA Committee, please contact Peter Werner in ISDA's EMEA Office in London.

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## Netting and Collateral Challenges in Cross-Border Transactions – Latin America

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**Sharmini Mahendran**  
Executive Director  
Morgan Stanley

**ISDA 26<sup>th</sup> Annual General Meeting  
Global Public Policy Developments  
4:00 PM, Thursday, April 14<sup>th</sup>**

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### Existing Netting Legislation in Latin America

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Netting Legislation has been passed in four major Latin American Jurisdictions. ISDA membership has been monitoring local jurisdiction development and ISDA has commissioned netting opinions in respect of each of the netting legislations.

#### Mexico

- Ley de Concursos Mercantiles (effective May 13, 2000)
- ISDA Netting Opinion commissioned from Ritch Mueller (December 10, 2001)

#### Brazil

- Law No. 11, 101 (effective June 9, 2005)
- Joint ISDA Netting Opinion commissioned from Pinheiro Neto Advogados and Mattos Filho Veiga Filho Marrey Jr. e Quiroga Advogados (December 21, 2005)

#### Chile

- Law No. 20,190 ("Second Capital Market Law") (June 5, 2007); Implementing Resolution (Resolution No. 1385) issued by Central Bank of Chile on January 17, 2008 (applies only to Chilean corporates); Implementing Resolution (Resolution No. 1427) issued by Central Bank of Chile on August 7, 2008 (limited netting applies to Chilean banks, insurance companies, pension funds, mutual funds and investment funds)
- ISDA Netting Opinion with respect to Chilean corporates commissioned from Carey y Cia Ltda. Abogados (October 19, 2009)

#### Peru

- Legislative Decree No. 1028 (effective as to netting provisions on December 1, 2008); implementing regulations (Circular No. G-142-2009) issued by the Banking, Insurance and Investments Superintendency with effect on June 4, 2009.
- ISDA Netting Opinion with respect to Peruvian financial institutions and insurance companies commissioned from Estudio Echeopar Abogados (March 15, 2010)

## Pending Netting legislation

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There is netting legislation pending in two major jurisdictions:

### Colombia

- **Financial Reform Law (Law 1328 of 2009) passed. Would give effect to close out netting of transactions registered in accordance with government regulations. FX regulations issued. Registration regulations to be implemented.**

### Argentina

- **Netting legislation pending.**

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## Peruvian Netting legislation

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Only applicable in respect of certain Peruvian counterparties and in respect of certain agreements.

### General Requirements:

- **The Defaulting Party is a Peruvian financial institution or insurance company that has been subjected to an intervention, dissolution or liquidation proceeding.**
- **The non-Defaulting Party must be either a (i) Peruvian financial institution or insurance company or (ii) a financial institution or insurance company in its jurisdiction of organization.**
- **The master agreement must be in a form approved by the Banking, Insurance and Investments Superintendency must include certain provisions required by the Superintendency, including:**
  - ✓ **Single agreement provision**
  - ✓ **Close out and netting provisions**
  - ✓ **Events of default and termination events**
  - ✓ **Provisions that allow the non defaulting party to terminate all transactions subject to the agreement upon the occurrence of an event of default**
  - ✓ **Provisions that determine how close out amounts will be calculated**
  - ✓ **Provisions that do not allow transfer of contractual rights and obligations or the modification of the contract's terms without the consent of both parties to the agreement**
  - ✓ **Provisions stating how disputes arising out of the agreement will be resolved**
- **Copies of the executed master agreement and schedule must be filed with the Superintendency before the intervention, dissolution or liquidation of the Peruvian Defaulting Party.**

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## **Trends/Common themes in Latin American existing and proposed netting legislation**

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- **Netting limited to certain types of counterparties (Chile, Peru, Colombia)**
- **Netting limited to certain proceedings (Brazil, Chile (for banks and institutional investors))**
- **Netting limited to certain types of agreements (Chile, Peru)**
- **Trend toward registration of agreements (Peru, Colombia)**



## Global Public Policy Developments in Canada

**Tracy Ross**  
Managing Director and  
Senior Counsel  
Royal Bank of Canada

**ISDA 26<sup>th</sup> Annual General Meeting**  
**Global Public Policy Developments**  
**4:00 PM, Thursday, April 14<sup>th</sup>**



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## Regulatory Landscape



### ➤ Federal level

- Banks are regulated at the federal level by the Office of the Superintendent of Financial Institutions (OSFI)
- Federal banking is also regulated by the Bank of Canada and the federal Department of Finance

### ➤ Provincial Level

- Each province and territory in Canada has their own securities commission which regulates securities markets in the province or territory
- This sometimes means different rules in 10 provinces (Alberta, British Columbia, Manitoba, Newfoundland and Labrador, New Brunswick, Nova Scotia, Ontario, Prince Edward Island, Quebec and Saskatchewan) and 3 territories (Northwest Territories, Nunavut, Yukon)
- Although each province or territory can have its own rules, there are also National Instruments which are rules that apply across all provinces and territories, and Multilateral Instruments which are rules that apply across some, but not all, provinces and territories

### ➤ Provincial Level (continued)

- Canadian Securities Administrators (CSA) bring together all of the securities commissions from the provinces and territories so they can develop consistent policies and regulations across Canada – even where there is no National Instrument or Multilateral Instrument, the CSA will try to ensure consistency
- There is also a “passport” system that often reduces the number of required approvals to one provincial approval that will be accepted by the other commissions
- Despite the moves to harmonization, there has always been a debate as to whether or not Canada should have a national securities regulator rather than separate provincial and territorial regulators

### ➤ National Securities Regulator

- On March 26, 2010 the federal Minister of Finance tabled a proposed draft national Securities Act
- The National Securities Act was tabled but not introduced. It will not be introduced until the Supreme Court of Canada rules on the constitutionality of the Act. Quebec and Alberta have also challenged the constitutionality of the Act in their own provincial courts of appeal.

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### ➤ National Securities Regulator (continued)

- Constitutional issue is whether or not the federal government has the legislative authority to adopt a national securities act
- Under the Constitution, the provinces are given power over “property and civil rights in the province” and they have regulated securities markets under this authority
- Under the Constitution the federal government was given power over “the regulation of trade and commerce” which has been interpreted by the courts as international and interprovincial trade and commerce. This would cover a lot of securities activity but may not cover securities activity within a single province.
- March 8, 2011 the Alberta Court of Appeal ruled that the national securities legislation is unconstitutional by ruling that securities regulation falls within the exclusive provincial jurisdiction under the provinces power over property and civil rights
- The Supreme Court of Canada’s decision is not expected until the summer. Quebec’s decision will likely come out before this.

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## Regulation of OTC Derivatives - Current



### ➤ Federal level

- Most of the OTC derivatives activity in Canada is concentrated in the banks which are regulated by OSFI at the entity level
- OTC derivatives are conducted by banks as the “business of banking” which is regulated at the federal level

### ➤ Provincial Level

- In the late 1990s and early 2000s, some provincial securities regulators (Alberta, British Columbia, Quebec) decided that derivatives should be treated like securities but they also issued exemptions for OTC derivatives between “Qualified Parties” (mainly institutions) – New Brunswick and Saskatchewan followed with similar rules and exemptions
- In other provinces/territories (PEI, NWT, Yukon, Nunavut), OTC derivatives are probably captured in the definition of securities and it is not clear if there are any exemptions to the securities rules (prospectus and registration requirements)
- In the remaining provinces, it is not clear to what extent OTC derivatives are captured in the definition of securities or futures

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## Regulation of OTC Derivatives - Current



### ➤ Provincial Level (continued)

- In provinces where there is uncertainty about OTC derivatives regulation, most market participants have assumed that the securities commissions would consider OTC derivatives as instruments that they regulate under their power to regulate securities
- In June 2008, Quebec brought into force a Derivatives Act but most institutional trades were exempt from many of the provisions
- Because regulation of banks as entities is not under provincial jurisdiction and Qualified Parties or accredited investors are exempt where there are derivatives rules, the vast majority of OTC derivatives activity in Canada is exempt under provincial regulation
- Even though some provinces are regulating derivatives (with significant exemptions) there have always been questions as to if the provincial securities acts give the provincial regulators the ability to regulate derivatives as they tend to be traded on an extraterritorial basis rather than in the province

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### ➤ Provincial Level (continued)

- Treating derivatives as “securities” does not really make sense because they trade very differently and it is not clear that the power to regulate securities includes the power to regulate derivatives
- Provinces can pass specific legislation to allow derivatives regulation (like Quebec did when they passed the Derivatives Act)
- Even with the ability to regulate OTC derivatives there is still some question of the ability of the provincial regulators to regulate banks which carry out the majority of derivatives activity but which are federally regulated
- This has resulted in a very fragmented regulatory environment for OTC derivatives

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### ➤ National Securities Regulator

- Canada’s decision to meet the G20 commitments to OTC derivatives reform highlight some of the policy arguments in favour of a National securities regulator
  - International nature of the OTC derivatives market and the need for global coordination
  - Stronger representation on international regulatory committees if there is one regulator who can speak for Canada. At international conferences Canada is often represented by Ontario and Quebec and in some cases Alberta and British Columbia as participants or observers but none of the provincial regulators can bind the other provinces so there is not one voice for Canada
  - IOSCO has 109 members and only 2 of those members do not have national securities regulators (Canada and Bosnia-Herzegovina)
  - Provinces have limited authority to regulate banks and extraterritorial matters
- Even if Canada does get a national securities regulator, it will not be in place in time to speak for Canada at an international level as the discussions on OTC derivatives are taking place now

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### ➤ National Securities Regulator (continued)

- The proposed National Securities Act contains an opt-in provision so it will only apply to provinces that choose to opt-in. In all other cases, the provincial securities regimes will remain in place.
- With the slow move to a national securities regulator and the opt-in provision which will apply if and when Canada has a National Securities Act, Canada is facing a fragmented regulatory regime for the current reforms in OTC derivatives

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### ➤ Federal Level

- The Canadian federal government is a signatory to the G20 commitments to OTC derivatives reform
  - Canada is committed to central clearing, electronic execution, trade reporting and increased capital requirements for non-cleared trades by end of 2012
- Bank of Canada and OSFI are working at the federal level to make sure Canada meets its G20 commitments. They are working with the federal Department of Finance and the CSA on the OTC Derivatives Working Group ("OTCDWG") to coordinate efforts to meet the G20 commitments and ensure consistency amongst the different regulators.
- Main focus now at the federal level is on standardization, clearing and reporting
- OTCDWG asked the Canadian banks and other large end users in Canada to form an industry group to advise on how to implement a clearing and reporting strategy that will work for the Canadian market. This industry group, the Canadian Markets Infrastructure Committee, has been evaluating different clearing strategies for Canada which will give the Canadian regulators oversight of the market

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### ➤ Provincial Level

- Provincial regulators have indicated that there will not be a National Instrument covering OTC derivatives so each province will have their own OTC derivatives rule
- Although each province will have its own OTC derivatives rule, they are committed to ensuring consistency, in substance, across the provinces by acting through the CSA to agree on policies that each province will implement within their own legislative framework
  - This still means that if you want to deal in Canada you will need to review the rules in each province where you may have counterparties

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### ➤ CSA

- In November 2010 the CSA published a consultation paper on OTC derivatives regulation. The paper covers the G20 commitments and requests comments on how the commitments can be implemented.
  - Clearing – CSA recommends mandatory clearing of OTC derivatives that are appropriate for clearing and capable of being cleared – further study required regarding the necessity of a Canadian solution versus the use of international clearing houses
  - Trade Repositories – Provincial securities laws should be amended to mandate the reporting of all OTC derivatives trades by Canadian counterparties to a trade repository
  - Electronic Trading – Where they do not already have it through legislation, provincial regulators should be granted the authority to mandate electronic trading of OTC derivatives but they would only do so for products which are sufficiently standardized and liquid and which pose a systemic risk to the market
  - Capital and Collateral – Higher capital and collateral requirements for non-centrally cleared OTC derivatives

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### ➤ CSA (continued)

- End-Users – Exemptions for defined categories of end-users but calls for further study
- Enforcement – Provincial regulators should be given further authority to conduct surveillance and investigations in the OTC derivatives markets
- Segregation of Collateral – Further study regarding the necessity to segregate counterparty collateral
- The CSA has been considering the comments it received and will be publishing a more detailed paper on OTC derivatives regulation in the coming months

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### ➤ Ontario

- Bill 135 – Helping Ontario Families and Managing Responsibility Act 2010
  - Passed in December 2010
  - Contains amendments to the Ontario Securities Act
  - Act gives the Ontario Securities Commission (“OSC”) the authority to regulate OTC derivatives including derivatives exchanges, clearing agencies and trade repositories
  - Includes a registration requirement for entities and individuals who trade OTC derivatives or provide advice in respect of OTC derivatives (unless an exemption applies)
  - Disclosure requirements for OTC derivatives that are not traded on an exchange or marketplace (with some exemptions)

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### ➤ Ontario (continued)

- Bill 135 amends the Securities Act as follows:

#### *Disclosure*

*154. The disclosure of information to the Commission or a trade repository that is made in good faith by a person or company in compliance or attempted compliance with Ontario securities law,*

*(a) does not constitute a breach of any contractual provision to which the person or company or any other person or company is subject; and*

*(b) does not constitute any other basis of liability against the person or company or any other person or company.*

- If the OSC makes it mandatory to report trade information to the OSC or to a trade repository, this disclosure language is meant to allow the reporting without requiring consent of the counterparty
- This avoids dealers from having to amend agreements or chase down counterparties to get consent in order to meet a mandatory reporting requirement

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### ➤ Ontario (continued)

- Bill 135 gives the OSC authority to regulate but they have not yet done so. They will wait for the CSA recommendations and attempt to create regulations consistent with those in the other provinces.
- Apart from Bill 135, section 21.2 of Ontario Securities Act became effective on March 1, 2011. This section states that "*no person or company shall carry on business in Ontario as a clearing agency unless the person or company is recognized by the Commission under this section as a clearing agency*".
- The OSC seems to be taking a very broad interpretation of "carrying on business in Ontario"
- This comes at a time when the mandatory clearing requirement in the United States is about to become effective so if Canadian entities with a significant presence in Ontario want to continue trading with US counterparties, they can only do so if the clearing house they are using is designated in the US and recognized or exempted in Ontario.

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### ➤ Alberta

- The Alberta Securities Commission (“ASC”) has proposed a repeal of Blanket Order 91-503 which exempts most OTC derivatives from regulation as futures (which are “securities”)
- Once 91-503 is repealed, a new rule (91-505) would become effective giving the ASC authority to regulate OTC derivatives
- The proposed 91-505 includes an exemption from the prospectus requirement and a limited exemption from the registration requirement
- The proposed registration exemption only applies to OTC physical commodity contracts
- The comment period on the proposed repeal and new rule closes on April 29, 2011