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ISDA Publishes French and Irish Law Master Agreements

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Background

In our November edition of Briefs for the Buy side[1], we reported that the International Swaps and Derivatives Association, Inc. ("ISDA") was seeking comment on whether a further two governing law options should be made available for the ISDA Master Agreement, which hitherto has been dominated by English and New York governing law. On 28 June 2018, ISDA announced that it had published Irish and French law versions of the 2002 ISDA Master Agreement (the "ISDA Agreement")[2].

At present, English law is the dominant governing law for ISDA Master Agreements between European Union ("EU") counterparties. Currently, a judgment given by an English court is automatically recognised by, and can be enforced in, any other EU Member State ("Member State"). However, this may change following the United Kingdom's ("UK") withdrawal from the EU ("Brexit").

A Pre-emptive Measure

ISDA has acknowledged[3] that in the absence of an appropriate agreement being reached between the UK and the EU in the Brexit process, an EU counterparty's ability to rely on the enforceability of an English court's judgment in a Member State[4] may be compromised, as the UK would be classified as a third country. Although, following Brexit, English court judgments would likely still be recognised and enforced in a Member State, the recognition and enforcement of the judgment of an English court in a Member State may not be 'automatic', in which case the recognition and enforcement process may be a costly and time-consuming process.

The publication of the Irish and French law versions of the ISDA Agreement is a largely pre-emptive measure. The use of an Irish or French law ISDA Agreement will eliminate the relevant uncertainty by ensuring automatic mutual recognition of judgments across Member States as, obviously, both the Republic of Ireland and France will remain as Member States following Brexit.

Flexibility Without Disruption

The two new governing law versions represent both the common law system (Irish law) and the civil law system (French law), thus allowing parties to effectively choose which system of law they prefer for their ISDA Agreements.

Unsurprisingly, considering the strong similarities and closeness of legal principles between English law and Irish law, relatively few amendments to the English law version of the ISDA Agreement were necessary in creating the Irish law version of the ISDA Agreement.

Many more deviations can be observed in the French law version of the ISDA Agreement, necessary to transpose into the French law version certain common law provisions and concepts which either do not exist or are not recognised in the same way under the civil law framework of French law. Perhaps the most notable of these is the concept of "flawed assets"[5], which is not recognised under French law, resulting in changes to the French law version of the ISDA Agreement to allow a party to suspend its payment and delivery obligations

if certain events occur and continue, but subject to the imposition of a time limit on its operation[6].

AB Trading Advisors View and Comment

Future Adoption

The creation of the new Irish and French law versions of the ISDA Agreement is a pre-emptive measure by ISDA. ISDA describes it as a "prudent approach"[7] to deal with the legal uncertainty of enforcing English court judgments in a Member State.

The fact that all Member States aside from Ireland (and to some extent Cyprus and Malta) operate legal systems derived from civil law might suggest that the French law ISDA Agreement may be chosen by counterparties established in 'civil law' Member States. However, the minimal deviation of the terms of the Irish law ISDA Agreement from the English law ISDA Agreement will arguably provide greater contractual certainty. Market participants will feel more familiar with the Irish law ISDA Agreement more generally, suggesting that it will be the more attractive choice, with a wider platform for usage.

Needless to say, the prevalence of either of these two new versions of the ISDA Agreement will depend on what sort of agreement is reached in UK/EU negotiations, and the clarification of the UK's status on withdrawal.

Other Benefits

Assuming that, following Brexit, the UK will be a third country for the purposes of the EU Bank Recovery and Resolution Directive (2014/59/EU) ("BRRD")[8], then certain European Economic Area ("EEA") counterparties will be required to include in an English law governed ISDA Agreement contractual recognition of bail-in clauses, whereby the non-EEA counterparty acknowledges an EEA regulator's power to cancel, convert or write-down the EEA counterparty's liabilities.

Additionally, some EEA jurisdictions require that non-EEA law governed agreements include contractual recognition of the BRRD's stay provisions (i.e., the temporary suspension of counterparties' rights to terminate the contract, enforce security and fulfil payment and delivery obligations). Using an Irish or French law governed ISDA Agreement would (from the perspective of EEA counterparties) avoid EEA counterparties needing to amend an English law ISDA Agreement to give effect to these requirements[9].

The above material is provided in brief, summary form. It is provided for information purposes only and should not be taken to constitute legal advice. Professional legal advice should be obtained before taking or refraining from any action in relation to the contents of this email.

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[1] Available at https://abderivs.com/client-news/november-2017-round-up-of-some-key-topics/

[2] Available on the ISDA website at https://www.isda.org/books/

[3] See ISDA's 'Brexit FAQs' published on 10 April 2018 and available at https://www.isda.org/2018/04/10/brexit-faqs/

[4] The Brussels I Regulation (EU) 1215/2012 (recast) dictates that any EU court respect and enforce judgments given in another EU court given jurisdiction to hear the claim by virtue of the contract.

[5] Section 2(a) (iii) of the Agreement is the 'flawed assets' provision stating that each payment / delivery obligation of each party under the Agreement is subject to a number of conditions precedent (including that that no event of default or potential event of default with respect to the other party has occurred and is continuing).

[6] We understand that the language in the French law Agreement will follow that proposed by ISDA for market participants that wish to

include a ‘use it or lose it’ clause to Section 2(a)(iii). Available at: https://www.isda.org/book/amendment-to-the-isda-master-agreement-for-use-in-relation-to-section-2aiii-and-explanatory-memorandum/ Under English law (without the aforementioned amendment), a party can rely on Section 2(a)(iii) to suspend performance of its obligations indefinitely.

[7] See ISDA Quarterly, Vol. 4, Issue 1: April 2018 available at: https://www.isda.org/books/

[8] Available at https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32014L0059

[9] However, depending on the legislative outcome of Brexit, a UK counterparty contracting under a non-English law Agreement may require the same contractual recognitions in respect of the equivalent UK measures.