



Safe,
Efficient
Markets

Islamic Derivatives - Law Reform in Islamic Jurisdictions

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Law Reform and ISDA

- The development and use of derivatives products has become ubiquitous spreading around the world
- Effective risk management requires legal certainty. In the ISDA context this means:
 - Enforceability of derivatives contracts (ISDA Master Agreements)
 - Clarity of insolvency law and enforceability of netting provisions
 - Clarity regarding the treatment of collateral

Law Reform and ISDA

- Significant variation in national insolvency and property laws around the world affects the enforceability of derivatives transactions under ISDA's netting and collateral agreements
- ISDA's law reform efforts aim at addressing these concerns, working with other multinational organizations as well as national authorities

Financial Market Law Reform: Key Questions

- Knowing where you stand: the practical value of increasing legal certainty
 - An abstract goal, but with concrete results: increased market confidence, more liquidity, greater financial stability
- Key questions:
 - Will my agreement be respected and enforced by a court or arbitration tribunal?
 - Will foreign law governed contracts and foreign based counterparties be treated equally?
 - Will it be enforced as written, both before and after my counterparty's insolvency?
 - How can I protect against the risk of my counterparty's insolvency?
 - Early termination and close-out netting under a master agreement
 - Set-off rights
 - Financial collateral arrangements and other forms of security
 - Guarantees, letters of credit, insurance, credit derivatives

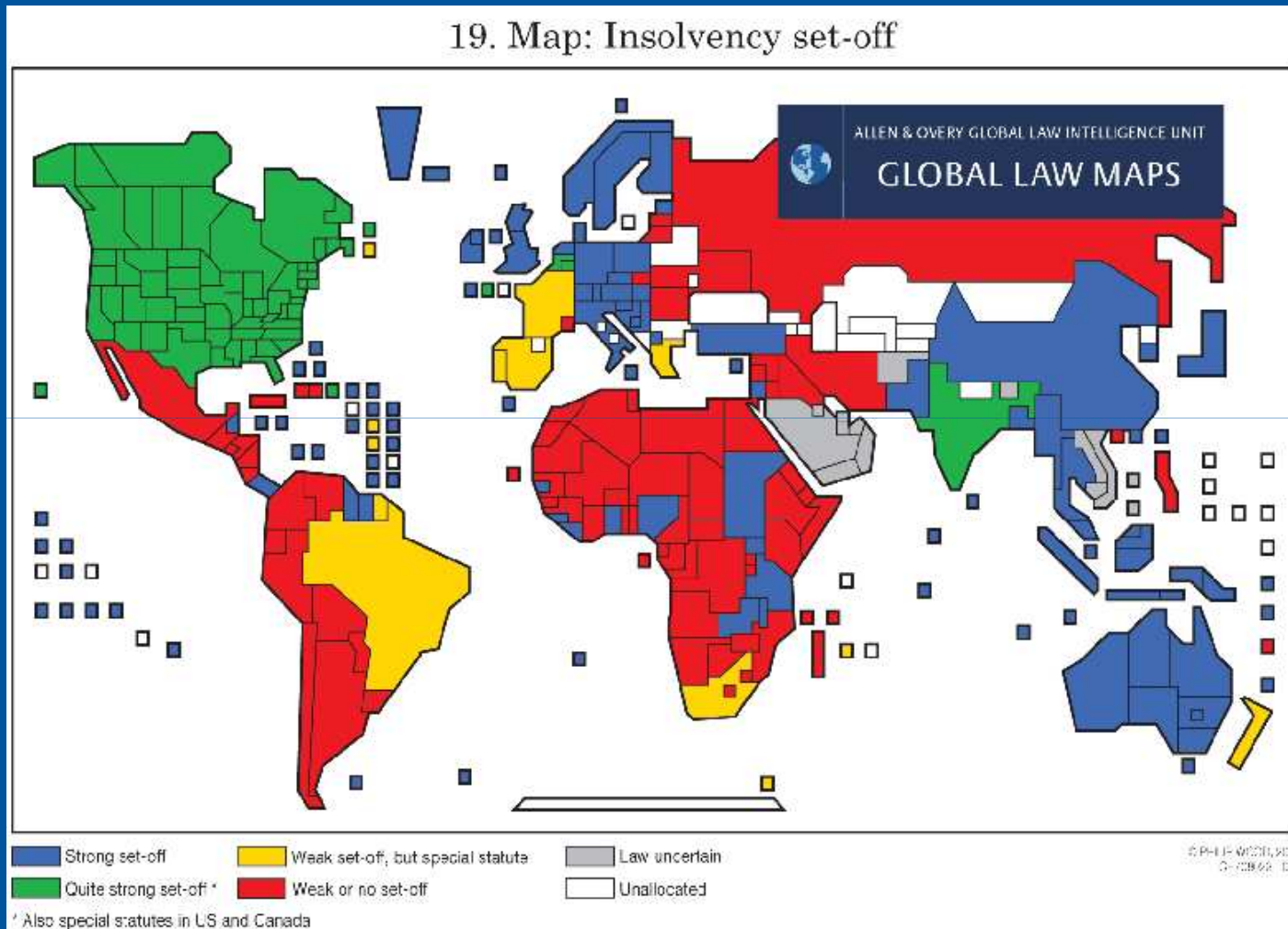
ISDA's Law Reform Efforts in Emerging Markets within EMEA

- Since 1987 ISDA has been developing standard contracts, recommendations and model laws on netting and for collateral transactions
 - ISDA netting legislation initiatives in EMEA, LatAm, Asia-Pac
 - ISDA Model Netting Act and Memorandum on Implementation of Netting Legislation (latest version published October 2007)
 - ISDA Master Agreements and supplemental standard documentation
- Focus countries in the EMEA region
 - CEE/SEE/CIS region
 - Middle East and N. Africa (incl. Islamic version of the ISDA MA)
 - Sub-Saharan Africa (ex-RSA): Mauritius, Nigeria, ECOWAS, SADC

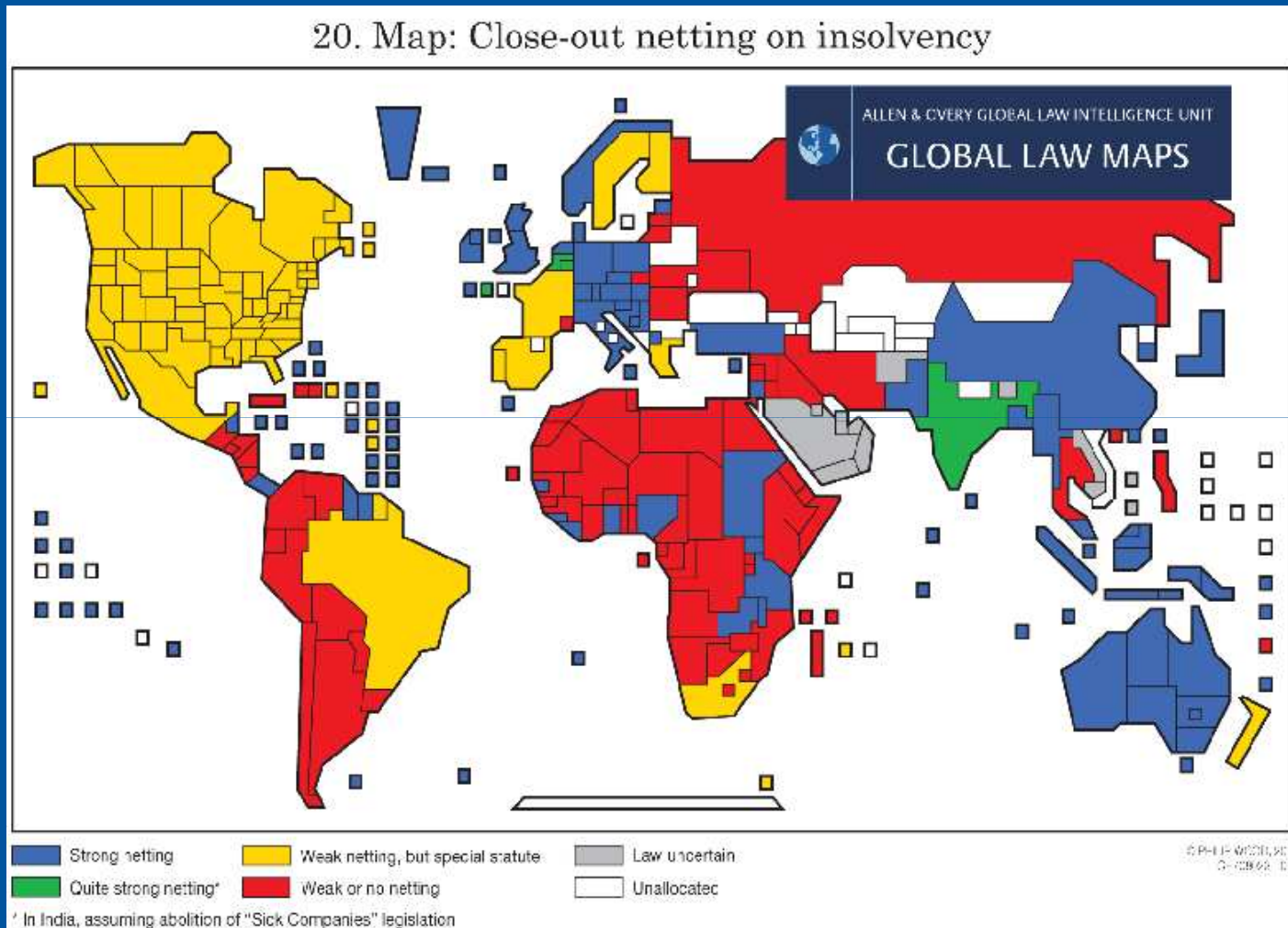
ISDA Netting Opinions 2011

- | | | |
|--------------------------------|--|-------------------|
| 1. Anguilla | 20. France | 39. New Zealand |
| 2. Australia | 21. Germany | 40. Norway |
| 3. Austria | 22. Greece | 41. Peru |
| 4. Bahamas | 23. Hong Kong | 42. Philippines |
| 5. Barbados | 24. Hungary | 43. Poland |
| 6. Belgium | 25. Iceland | 44. Portugal |
| 7. Bermuda | 26. India | 45. Scotland |
| 8. Brazil | 27. Indonesia | 46. Singapore |
| 9. B.V.I. | 28. Ireland | 47. Slovakia |
| 10. Canada | 29. Israel | 48. Slovenia |
| 11. Cayman Islands | 30. Italy | 49. South Africa |
| 12. Channel Islands - Guernsey | 31. Japan | 50. South Korea |
| 13. Channel Islands - Jersey | 32. Luxembourg | 51. Spain |
| 14. Chile | 33. Malaysia | 52. Sweden |
| 15. Cyprus | 34. Malta | 53. Switzerland |
| 16. Czech Republic | 35. Mauritius | 54. Taiwan |
| 17. Denmark | 36. Mexico | 55. Thailand |
| 18. England | 37. Netherlands | 56. Turkey |
| 19. Finland | 38. Curacao/St.Maarten
(ex-NL Antilles) | 57. United States |

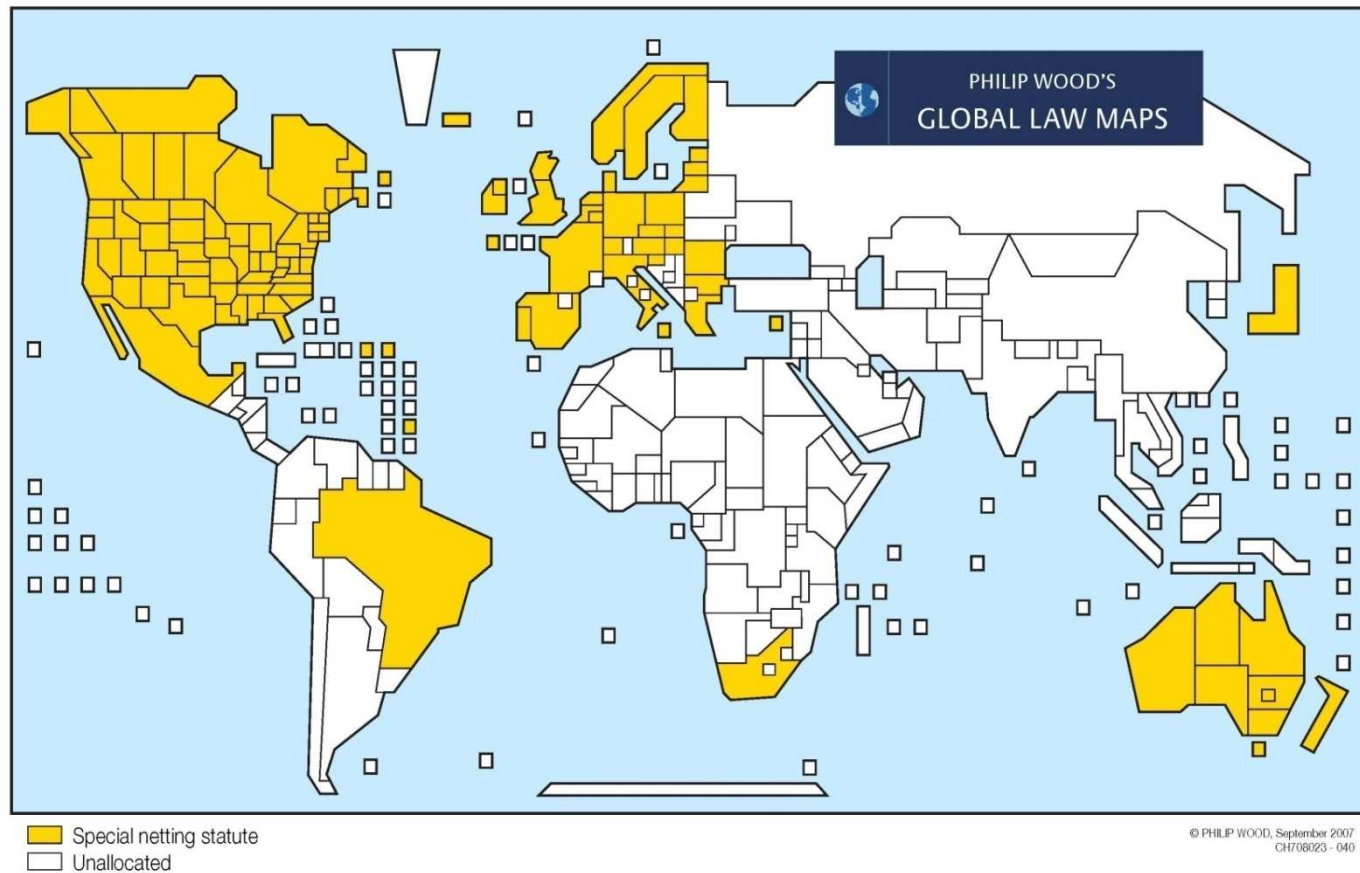
19. Map: Insolvency set-off



20. Map: Close-out netting on insolvency



21. Map: Special netting statutes



Selected Int'l Legal Instruments

- UNCITRAL Legislative Guide on Secured Transactions
- UNCITRAL Legislative Guide on Insolvency
- UN Convention on the Assignment of Receivables in International Trade
- UN Convention on Contracts for the International Sale of Goods
- Geneva Securities Convention
- Hague Securities Convention
- Hague Choice of Court Convention
- EU Directive on Financial Collateral Arrangements + Amending Directive
- EU Directives on Winding-up of Banks and Insurance Undertakings
- EU Insolvency Regulation
- EU Regulation (Rome I) on the Law Applicable to Contractual Obligations
- EU Regulation (Brussels I) on the Recognition and Enforcement of Judgments in Civil and Commercial Matters
- Other law reform initiatives affecting international finance (e.g. proposals for an EU instrument on netting)
- New York Convention (arbitration in derivatives disputes; ISDA memos)
- UNIDROIT global instrument on netting (Draft Principles published in early Apr 2012)

Islamic Jurisdictions in the Middle East, N. Africa and the Far East

- GCC region (primarily UAE, Bahrain, Qatar plus Saudi Arabia)
- North Africa: Egypt, Morocco
- Greater Middle East: Pakistan
 - Lack of proper netting legislation
 - Various other general legal issues relevant (general issues around contract, property and insolvency law plus conflict rules)
- Far East: Malaysia, Indonesia
- In the future? Kuwait, Oman, Jordan, Lebanon, Tunisia, Algeria, Nigeria plus Brunei, Indonesia
- World Bank/UNCITRAL/OECD project on insolvency laws in MENA region

Islamic Jurisdictions and the role of the Shariah

- Shariah – Islamic principles and rules governing the conduct of both legal and personal matters (often referred to as “Shariah law”)
- Applied in different ways and to varying extents in Islamic jurisdictions
- Not a single, absolute set of universal rules
- Contrast the law of a country with a non-national system of laws and principles

Conflict of laws, rules and the Shariah

- Can the Shariah be chosen as the governing law of a contract?
 - Shamil Bank of Bahrain EC v. Beximco Pharmaceuticals Limited & Others [2004]
 - “Subject to the principles of the Glorious Sharia, this Agreement shall be governed by and construed in accordance with the laws of England.”
- Compliance with the Shariah and enforceability
 - The Investment Dar Company KSCC v. Blom Development Bank SAL [2009]

Current Issues: UAE

- No UAE-wide netting regime
- Various regulators in charge of OTC derivatives: UAE Central Bank, Emirates Securities & Commodities Agency, DIFC/DFSA, ministries
- Court system disparate among the seven emirates that constitute the UAE. Divergent judgments out of Dubai and Abu Dhabi courts.
- ESCA proposal for introduction of netting regulations
- ISDA meetings with UAECB, ESCA
- ISDA proposal to DIFC/DFSA. Current DIFC regulations do not address close-out netting
- Suggestions to develop an UAE-wide insolvency regime based on DIFC regulations (cf. Decree Law No 57/ 2009 of 14 December 2009)
- Proposals to revise the federal Insolvency Code and Commercial Transactions Law
- Uncertainties regarding choice of foreign law governing the contract
- Enforceability of foreign judgments doubtful. More positive re arbitral awards

Current Issues: Qatar

- Separation between “onshore” and “offshore” jurisdiction (QFC) to be lifted in the long run
- No netting provisions in “onshore” legal system
- QFC:
 - QFC Financial Services Regulations, Art.106, addresses wagering issues (different from Art.275 Penal Code)
 - Free choice of law governing the contract, Art.6-7 QFC Contract Regulations
 - QFC Insolvency Regulations, Art.195, covers “futures and options”. What about swaps and forwards?
 - “Contracts for investment purposes, not commercial purposes”, QFC Financial Services Regulations, Schedule 3, Part 3, plus Art 11.2 QFC General Rulebook;
 - Physically settled transactions not covered
 - Art.107 QFC Insolvency Regulations, set-off

Current Issues: Bahrain

- No specific netting legislation, but CBB plans to change this shortly
- Art. 36 Bankruptcy Act, post-insolvency set-off possible for “interrelated” transactions created by “the same cause” and “covered by the same account”.
- Right to set-off needs to be expressly stated in contract
- Art.108-109 of the Central Bank of Bahrain and Financial Institutions Law (Decree No.64 of 2006): Concept of “automated” netting for “market contracts”
 - Definition of “market contracts” subject to CBB regulations which have not been issued yet
 - Art.136 Law of Commerce (Decree No.7 of 1987) recognises concept of pledge
 - Art.95 Law of Commerce: CBB has powers to define characteristics of security interest collateral arrangements, but has not done so yet

Current Issues: Saudi Arabia

- No netting legislation
- High risk of re-characterisation
- But CMA regulations on certain types of swaps
- Strong need to stay within special CMA regime for dispute resolution
- Biggest economy in GCC region; home of future central bank for GCC monetary union

Current Issues: Kuwait

- No re-characterisation risk re. wagering or insurance, but possible re. title transfer
- Exclusive jurisdictions clauses ineffective as soon as one counterparty is Kuwaiti
- Foreign judgments unenforceable
- Arbitral awards enforceable
- Special Central Bank of Kuwait Instruction allows for certain types of derivatives transactions to be entered into by banks
- No netting legislation. Courts unlikely to permit netting “to the detriment of third parties”. No definition of this criterion available, in the sole discretion of the court.

Current Issues: Pakistan

- In 2006, State Bank of Pakistan started drafting Netting of Financial Contracts Act.
- Adopted by Cabinet in August 2009, submitted to parliament for further discussions
- Act based on ISDA Model Netting Act and EU Collateral Directive. Reflects additional ISDA comments provided.
- Addresses title transfer and security interest collateral arrangements
- Foreign counterparties expressly included
- Final adoption during current parliamentary term or falling victim to new constitutional rules on expiry of draft bills?

For further information

For further information about any of these ISDA projects or to participate in the work of the ISDA Financial Law Reform Committee, contact Peter Werner in London: pwerner@isda.org

Please join:

ISDA CEE/EMEA Committee http://www.isda.org/c_and_a/eastern_eur.html

ISDA Islamic Finance Committee http://www.isda.org/c_and_a/islamfwg.html

ISDA Financial Law Reform Committee
http://www.isda.org/c_and_a/collateralFinancial.html