

**Asia-Pacific Financial Forum  
Interim Report to the APEC Finance Ministers**

**ANNEX D  
Netting and Collateral Issues in APEC**

## Netting Issues – Country Specific Analysis

NAME OF COUNTRY	NETTING ISSUE(S)	MOVING FORWARD
People's Republic of China	<ul style="list-style-type: none"> <li>▪ In September 2013, China's Supreme Court issued interpretation of set-off provisions in China's Enterprise Bankruptcy Laws that provided welcome clarity and enhanced contractual protection for creditors.</li> <li>▪ However, there still exist some uncertainties regarding enforceability of close-netting in China given China does not have a netting legislation. Work remains to be done for the purpose of providing the netting certainty required by Basel for regulatory capital purposes and by CPSS-IOSCO for qualifying CCP purposes.</li> </ul>	<ul style="list-style-type: none"> <li>▪ ISDA has commissioned a memorandum on the current gaps to netting certainty to facilitate analysis of required next steps.</li> <li>▪ Domestic institutions such as Shanghai Clearing House also understand the importance of netting certainty and together with PBOC have begun dialogue with law making authorities within the State Counsel.</li> <li>▪ Formal revision of the 2007 Enterprise Bankruptcy law would be one possibility; another would be to include provisions similar to what a netting legislation entails for financial contracts in the draft Financial Institution Bankruptcy Regulations. ISDA contributed netting language to the original draft of the Regulation in 2008. A new sense of urgency might provide the impetus to finalize this guidance.</li> </ul>
Indonesia	<ul style="list-style-type: none"> <li>▪ Indonesian counsel has opined that the close-out netting provisions of the ISDA Master Agreement would be enforceable, taking into consideration, among others, Section 1425 (and subsequent provisions) of the Indonesian Civil Code and the Article 52 of the Indonesian Bankruptcy Law</li> <li>▪ However, Indonesian counsel has highlighted that there is a considerable degree of uncertainty with respect to the material content of legal rules, including the scope and enforceability of such rules, taking into account the framework of Indonesian law, a lack of relevant precedents as well as a relatively unsophisticated derivatives market.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Counterparties should consider, among others, the following:               <ul style="list-style-type: none"> <li>i) In order to avoid foreign currency prohibition on payments under the Currency Law passed in 2011, the parties should expressly concur in writing in each contract which payment is to be made in foreign currency other than Rupiah.</li> <li>ii) Foreign banks entering into derivative transactions with Indonesian counterparties should observe the Derivatives Decree which provides a variety of provisions to be included in the documentation.</li> </ul> </li> </ul>
Republic of Korea	<ul style="list-style-type: none"> <li>▪ The close-out netting provision of the ISDA Master Agreement would be enforceable under the law of Korea with the following qualifications:               <ul style="list-style-type: none"> <li>i) Bullion, longevity and physical commodity transactions may not fall within the scope of "a forward, option or swap transaction" and, hence, may not qualify as a Qualified Financial Transaction for purposes of Article 120 and Article 336 of the Debtor Rehabilitation and Bankruptcy Law (DRBL).</li> <li>ii) Based on the "Preference Provision" of the Banking Law, in the event of liquidation or bankruptcy of a local branch of a foreign bank, Korean court might not enforce the close-out netting provisions of the ISDA Master Agreement in order to satisfy preferentially the claims of Korean citizens or foreigners resident in Korea against the branch.</li> </ul> </li> <li>▪ In addition, in respect of Corporate Restructuring Promotion Law (CRPL) proceedings, counsel recommend that the 15 day grace period in Section 5(vii)(4) of the 2002 Master Agreement or the 30 day grace period in Section 5(vii)(4) of the 1992 Master Agreement be eliminated. This is because under the DRBL, upon commencement of Rehabilitation Proceedings, all creditors' enforcement actions (including disposition of collateral) would be automatically stayed. Although this amendment to the ISDA Master Agreement is recommended in the ISDA netting opinion, in practice, Korean counterparties have been unwilling to agree to such amendment and accordingly subject their foreign counterparties to increased counterparty credit risk.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Uncertainty in netting arises from the "Preference Provision" for protecting Korean citizens or resident foreigners. Regulators need to make (partial) amendment to the provision in that the opinion satisfies general regulatory standards.</li> <li>▪ Recommend incorporation of a carve-out to the automatic stay under the CPLR applicable to credits' enforcement actions regarding Qualified Financial Transactions in order to eliminate the residual collateral enforcement risks.</li> </ul>
Malaysia	<ul style="list-style-type: none"> <li>▪ Malaysian counsel has opined that prior to insolvency intervening, contractual set-off rights (which include</li> </ul>	<ul style="list-style-type: none"> <li>▪ ON 25 October, the Malaysian Prime Minister and Minister of Finance tabled the 2014 Malaysia</li> </ul>

	<p>the close-out netting provisions under the ISDA Master Agreement) would be available and thus the exercise of close-out netting rights under the ISDA Master Agreement would be enforceable against a Malaysian-incorporated counterparty. Upon insolvency contractual set-off rights would be enforceable only to the extent that such rights are consistent with the statutory right of set-off.</p> <ul style="list-style-type: none"> <li>▪ Concerns over close-out netting arise due to the following statutes: <ul style="list-style-type: none"> <li>i) Pengurusan Danaharta Nasional Berhad Act 1998 (Danaharta Act);</li> <li>ii) Malaysia Deposit Insurance Corporation Act 2011 (replacing the Act of 2005) (MDIC Act); and</li> <li>iii) Capital Markets and Services (Amendment) Act 2011 (CMSA Act)</li> </ul> </li> </ul>	<p>Budget Speech in which he stated, among others, that amendments will be made to existing laws and Bank Negara Malaysia will lead the initiative in formulating the Netting Act to protect enforcement rights of “close-out netting” under the financial contract.</p>
Peru	<ul style="list-style-type: none"> <li>▪ Under Peruvian law, the close-out netting provisions of the ISDA Master Agreement takes effect upon the insolvency of a Peruvian counterparty. However, in the case of Financial Institutions, pursuant to Article 116 of the Banking Law and Circular N° G-155-2011 issued by the Superintendencia de Banca Seguros (SBS), the close-out netting provisions are only enforceable when triggered by an event of default under section 5(a)(vii) of the agreement and only if the ISDA Master Agreement is entered into with 1) another Financial Institution, 2) an entity supervised and regulated by the SBS or the SMV, or 3) an entity organized outside Peru that is similar in nature to a Financial Institution and that is also subject to regulation and supervision in its home jurisdiction.</li> <li>▪ In addition, Peruvian law imposes other conditions of validity in the jurisdiction of the Financial Institution’s counterparty, no alteration of specified Sections of the ISDA Master Agreement, and the requirement that copies of the executed ISDA Master Agreement, all applicable schedules and annexes (excluding confirmations) be filed with the SBS prior to the intervention, dissolution or liquidation of the Financial Institution.</li> </ul>	
The Philippines	<ul style="list-style-type: none"> <li>▪ Philippine counsel has opined that the close-out netting provisions of the ISDA Master Agreement would be enforceable, taking into consideration, among others, Article 1278 of the Philippine Civil Code.</li> <li>▪ However, Philippine counsel has also highlighted that certain provisions of the Philippine Civil Code may limit the range of transactions entered into with Philippines counterparties that would enjoy netting enforceability.</li> <li>▪ According to “Risk Management Guidelines for Derivatives” issued by the Philippine Central Bank, the following measures are recommended: <ul style="list-style-type: none"> <li>i) For Philippine Banks, non-bank financial intermediaries performing quasi-banking functions or their subsidiaries or affiliates engaged in related financial activities acting as end users or dealers in their own capacity, they must represent the purpose of the transactions if it is for hedging.</li> <li>ii) All Philippine counterparties must demonstrate that transactions are entered into with an underlying legitimate business or economic purpose and not for speculation. Also, they should represent that they have obtained any applicable license or permit necessary to enter into transactions.</li> </ul> </li> </ul>	
Russia	<ul style="list-style-type: none"> <li>▪ The Russian netting opinion is in its final stages and</li> </ul>	<ul style="list-style-type: none"> <li>▪ In light of netting legislation not being fully</li> </ul>

	<p>currently is under review by ISDA.</p> <ul style="list-style-type: none"> <li>▪ The local netting regime is connected to required trade reporting. That is, netting in Russia only works once trade reporting is up and running.</li> <li>▪ Reporting requirements have been legally in place since early November, but only for a limited number of transaction types. Furthermore, the infrastructure for TRs (there are two local TR operators) is not working properly. Hence, notwithstanding the legal framework, the market infrastructure is not in place.</li> </ul>	<p>operational due to the lack of TR infrastructure, ISDA (in co-operation with both Russian TR operators as well as NAUFOR (local securities market SRO)) is in touch with Central Bank of Russia as the newly appointed sole regulator (as of Q4 2013). ISDA has set up a joint working group that has made submissions to CBR seeking clarification on the operability of trade reporting. Two workshops hosted by ISDA and EBRD have been held with Russian regulators and market participants (including(?)TR) to discuss practical and technical solutions to the public. Next submission due in February 2014 followed by another workshop.</p>
Vietnam	<ul style="list-style-type: none"> <li>▪ ISDA has not obtained any netting opinions for Vietnam.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Vietnam intends to enact a new Bankruptcy Law in June 2014 with a view to implementation by year-end. This is in recognition of the fact that the current bankruptcy law has not been effective (with many “zombie” companies in existence; it was also estimated that there have been only about 100 cases filed in the HCMC courts in the last 10 years). The IFC is assisting Vietnam in the project.</li> <li>▪ ISDA was invited to attend the consultation meetings jointly conducted by the Supreme People’s Court of Vietnam, the Vietnam Business Forum Consortium and the IFC. ISDA lobbied for the inclusion of a safe harbor for close-out netting and has proposed language to be included in the draft Bankruptcy Law.</li> </ul>

## Collateral Issues – Country Specific Analysis

NAME OF COUNTRY		COLLATERAL ISSUE			RECOMMENDATION		
		New York Law Pledge	English Law Security Interest	English Law Title Transfer			
Indonesia	<b>Governing Law – Creation of Security Interests</b>	<ul style="list-style-type: none"> <li>▪ Indonesian counsel has highlighted that there is a lack of sources of private international law precedents and coverage of the contractual aspects of security interest by Indonesian legal writers. As such, Indonesian counsel has considered issues of private international law in this context based on Dutch private international law as it has evolved over the past decades (excluding legislation implemented, or case law published, as a result of European directives or treaties.)</li> <li>▪ With respect to the creation of a security interest in tangible assets (including, among others, Eligible Collateral in the form of bearer and payable to order debt securities, the law of location of collateral).</li> <li>▪ With respect to the creation, perfection, recognition and enforcement of a fiduciary transfer of intangible assets (such as personal rights), there are essentially two views in Dutch literature, one being the law governing the underlying assets to be encumbered will also govern its transfer and the other governing the obligation to create the security interest is the proper law (i.e. the law governing the security agreement). To the extent that these laws are different, when creating a security interest, Indonesian counsel has stated that it is advisable to comply with the requirements of both laws.</li> <li>▪ However, unless the relevant requirements for the creation of a valid security interest under Indonesian law are complied with, an Indonesian court may not recognize the validity of a security interest in an asset located in Indonesia created under a Security Document governed by English or New York law.</li> </ul>	English Law Security Interest	English Law Title Transfer	<ul style="list-style-type: none"> <li>▪ In order to avoid foreign currency prohibition on payments under the Currency Law passed in 2011, the parties should expressly concur in writing in each contract which payment is to be made in foreign currency other than Rupiah.</li> </ul>		
	<b>Governing Law – Perfection of Security Interests</b>						
	<b>Perfection Requirements</b>					<ul style="list-style-type: none"> <li>▪ Indonesian counsel has noted that notwithstanding that there are no specific requirements regarding perfection of a security interest, in order for an Indonesian court to recognize such security interest, relevant mandatory requirements for the creation of a security interest under Indonesian law must be satisfied. For example, the creation of an Indonesian fiduciary transfer or right of pledge is required and these requirements differ and may be onerous.</li> </ul>	Not Applicable
	<b>Priority against competing creditors</b>					<ul style="list-style-type: none"> <li>▪ In general, if a secured party has been granted a security interest (through a pledge or fiduciary transfer) in the Eligible Collateral and its creation complies with mandatory Indonesian law requirements, then a secured party will have priority over (almost) all other claims.</li> </ul>	Not Applicable
	<b>Preferred claims</b>	<ul style="list-style-type: none"> <li>▪ In special claim cases such as payment of the costs of foreclosure, payment of the costs incurred after execution of the pledge and payment to tax authorities, these creditors' claims will take precedence.</li> <li>▪ Specific claims which an Indonesian court classifies as an exception would also take precedence over secured claims.</li> </ul>	Not Applicable				

Republic of Korea	<b>Governing Law – Creation and Perfection of Security Interests</b>	<ul style="list-style-type: none"> <li>▪ Under the Korean choice of law rules, the validity (together with all proprietary aspects such as perfection, priority, foreclosure) of a security interest is governed by the law of the jurisdiction where the collateral is located: <ul style="list-style-type: none"> <li>(i) Cash credited to an account – With respect to cash held outside Korea, the laws of the jurisdiction where such cash is held would be deemed to be the governing law for the protection of a security interest, but a security interest in cash held in Korea could not be recognized by Korean law.</li> <li>(ii) A directly held bearer debt securities – the law of jurisdiction where security certificate is physically located would govern security interest in the security.</li> <li>(iii) A directly held registered debt securities or a directly held dematerialized debt securities - the law that governs the rights entailed in the securities would be the governing law as to a security interest in such securities.</li> <li>(iv) Intermediated debt securities - the relevant law that governs a security interest in the securities is unsettled under the Private International Law.</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>▪ It is not clear how a title transfer arrangement would be characterized under Korean law and there may be advantages to the arrangement being characterized as either a security interest or one that functions as collateral that is protected under the Korean netting legislation.</li> </ul>	<ul style="list-style-type: none"> <li>▪ <b>For New York Law Pledge &amp; English Law Security Interest:</b>  Counsel recommends that the 30 day (or 15 day in the 2002 Master Agreement ) grace period in Section 5(a)(vii)(4) should be eliminated so that in the case where a petition for rehabilitation proceedings is filed, enforcement of rights can occur prior to the formal commencement of proceedings (when an automatic stay will apply).  In practice, Korean counterparties have been unwilling to agree to such amendment and accordingly subject their foreign counterparties to increased counterparty credit risk.  We would recommend adoption of a carve-out to the automatic stay under the CPLR applicable to creditors' enforcement actions regarding Qualified Financial Transactions in order to eliminate the residual collateral enforcement risks.</li> </ul>
	<b>Creation and Perfection of a pledge over local collateral</b>	<ul style="list-style-type: none"> <li>▪ Cash: Korean law does not recognize a pledge of cash; a security interest can only be established on a Cash Deposit. Under Korean law, the pledge of a claim that is effective against all parties (including the obligor of the pledged claim) requires the collateral provider to send a fixed-date stamped notice to or to obtain a fixed-date stamped consent of, the obligor of the pledged claim, i.e., the depository bank.</li> <li>▪ Securities (i.e., bonds issued in Korea, denominated in Korean Won that will be paid or delivered by book-entry through the settlement system operated by the Korea Securities Depository (“KSD”): under Korean law, the pledge of book-entry securities such as the securities is created and perfected in the following manner: <ul style="list-style-type: none"> <li>(i) If the Collateral Provider maintains an account with the KSD, an application is made by the Collateral Provider to the KSD for the pledge and the KSD makes an entry into the Collateral Provider’s account with a statement to the effect that certain designated securities in the account are pledged to the Secured Party together with the address of the Secured Party.</li> <li>(ii) If the Collateral Provider is not a participant of the KSD but has an account with a Custodian that is a participant of the KSD, the Custodian (upon the instruction of the Collateral Provider) makes an entry into the Collateral Provider’s securities account with a statement to the effect that certain designated securities in the account are pledged to the Secured Party together with the address of the Secured Party.</li> </ul> </li> </ul>	Not Applicable	<ul style="list-style-type: none"> <li>▪ <b>English Law Title Transfer:</b>  Although the risk is smaller in respect of the Transfer Annex, Counsel also recommends disapplying the bankruptcy event of default grace period, so that in the case where a petition for rehabilitation proceedings is filed, enforcement of rights can occur prior to the formal commencement of proceedings.  The same recommended legislative change set out above applies to the Transfer Annex as well. In addition, we would also recommend the definition of “Tambo” used in Article 120, Paragraph 3 and Article 336 of the DRBL be clarified to cover title transfer arrangement.</li> </ul>
	<b>Preferred claims under Korean bankruptcy laws</b>	<ul style="list-style-type: none"> <li>▪ Under Korean law, certain preferred claims such as “Yuchi Kwon” (a possessory lien), tax claims and claims for a limited amount of unpaid wages would be accorded priority over a secured party.</li> </ul>	Not Applicable	
Malaysia	<b>Governing Law –</b>	<ul style="list-style-type: none"> <li>▪ The law governing the contractual aspects of a security interest would be recognized as the</li> </ul>	Not Applicable	-

<b>Creation of Security Interests</b>	governing law of the Security Documents, provided that the choice of law was made bona fide and the Security Documents do not contravene any laws or public policy of Malaysia, save where the laws require creation to be in accordance with the laws where the Eligible Collateral is situated.		
<b>Governing Law – Perfection of Security Interests</b>	<ul style="list-style-type: none"> <li>▪ Under the laws of Malaysia, the law of jurisdiction with respect to the perfection of security interest depends on the type and the location of collateral: <ul style="list-style-type: none"> <li>(i) cash credited to an account – law of jurisdiction where the cash is held in practice or the account in which cash is deposited is located.</li> <li>(ii) directly held bearer debt securities – law of jurisdiction where the certificate of such security is located.</li> <li>(iii) directly held registered debt securities – law of jurisdiction where register of such security is archived.</li> <li>(iv) directly held dematerialized debt securities – law of jurisdiction where the depository is established and where it keeps the account in which the entitlements of the depositors are recorded.</li> <li>(v) intermediated debt securities – law of jurisdiction where the Intermediary is located and where the depositors’ account is kept.</li> </ul> </li> </ul>	Not Applicable	
<b>Perfection Requirements</b>	<ul style="list-style-type: none"> <li>▪ The security interest created under the security documents would need to be registered if its, among others, a charge over shares of a subsidiary if a company which are owned by that company, a floating charge on the undertaking or property of a company or a charge on the credit balance in any deposit account.</li> <li>▪ In the event these fail to be registered, then the charge over the collateral would be void. With respect to charged assets which are owned by Malaysian companies or a branch of a foreign company in Malaysia, the assets would be subject to the relevant provisions and requirements of the Companies Act 1965.</li> <li>▪ A collateral taker should adhere to perfection of security interest in collateral which a third party holds through the notice of its interest to that third party.</li> <li>▪ Under the Exchange Control Act 1953, particular types of security are required for registration. Certain banks would be exempted from registration.</li> </ul>	Not Applicable	
<b>Priority against competing creditors</b>	<ul style="list-style-type: none"> <li>▪ Although in Malaysia, secured interest is in general governed by the common law priority rules, specific legislation such as Section 292 of the Companies Act 1965 could affect general laws of priority as noted above. In summary, general laws of priority may be affected by priorities conferred by specific legislation.</li> </ul>	Not Applicable	
<b>Preferred claims</b>	<ul style="list-style-type: none"> <li>▪ Certain preferred creditors would exercise priority over a floating charge. Once secured creditors have been paid out of the assets that comprise their security, the remainder of the assets will be distributed among the preferred creditors in the order prescribed in the Companies Act 1965.</li> </ul>	Not Applicable	

		<ul style="list-style-type: none"> <li>Clearing houses could also have priority in circumstance where the collateral provider transacts through clearing houses.</li> </ul>		
Thailand	<b>Governing Law – Creation of Security Interests</b>	<ul style="list-style-type: none"> <li>The courts of Thailand should recognize the foreign governing law of the place of the creation and perfection of the security interest on Eligible Collateral located in such foreign country, unless it is considered contrary to the public order or good morals of the people of Thailand.</li> </ul>	Not Applicable	
	<b>Governing Law – Perfection of Security Interests</b>	<ul style="list-style-type: none"> <li>As there are no Supreme Court precedents on this issue, Thai law rules in respect to determining location are unsettled.</li> <li>Under the Conflict of Law Act, the creation and perfection of a security interest is governed by the law of the place where the property is situated, <i>lex situs</i>. In determining the location of such Eligible Collateral, the court will consider the physical location of such asset as <i>prima facie</i> location. In determining which law is the <i>lex situs</i>, as an indicative guideline, a Thai court may consider that the location of each of the following types of assets will be the place: <ul style="list-style-type: none"> <li>(i) Directly held bearer debt securities - law of jurisdiction where the certificate is located</li> <li>(ii) Directly held registered debt security - law of jurisdiction where the register is located</li> <li>(iii) Directly held dematerialized debt security - law of jurisdiction where the register is located</li> <li>(iv) Indirectly held debt securities - law of jurisdiction where the intermediary is located</li> <li>(v) Cash collateral - law of jurisdiction where the entity with which the cash is deposited is located.</li> </ul> </li> </ul>	Not Applicable	
	<b>Perfection Requirements</b>	<ul style="list-style-type: none"> <li><b>Counterparty in jurisdiction/ Collateral out of jurisdiction</b> <ul style="list-style-type: none"> <li>(i) Under the laws of Thailand, the law of jurisdiction with respect to the perfection of security interest depends on the type and the location of collateral.</li> <li>(ii) Collateral which is located outside of Thailand would be required to follow the same creation and perfection procedures as the collateral in Thailand.</li> </ul> </li> <li><b>Other Cases</b> <ul style="list-style-type: none"> <li>(i) Under the laws of Thailand, the law of jurisdiction with respect to the perfection of security interest depends on the type and the location of collateral.</li> <li>(ii) With respect to bonds issued by government or by other state-owned entities, the terms and conditions thereof will normally be attached to the bonds. There is no restriction on the transferor pledge of such bonds, provided that the transfer of title or pledge is registered with the Bank of Thailand as the registrar.</li> </ul> </li> </ul>	Not Applicable	
	<b>Priority against competing creditors</b>	<ul style="list-style-type: none"> <li>In general, a perfected of security interest has priority.</li> </ul>	Not Applicable	
	<b>Transferring</b>	Not Applicable	<ul style="list-style-type: none"> <li>In certain</li> </ul>	



	<b>Title</b>		circumstances, certain modifications to the Transfer Annex may be necessary depending on the type of entity, the collateral involved and the financing structure under the master agreement.	
	<b>Preferred claims</b>	<ul style="list-style-type: none"> <li>▪ With respect to preferential rights, the priorities under Thai law would generally depend on whether these are general preferential rights or special preferential rights.</li> </ul>	Not Applicable	

## APEC Netting and Collateral Opinions Summary Matrix

NO.	NAME OF COUNTRY	STATUS OF NETTING LEGISLATION	STATUS OF ISDA NETTING OPINIONS	STRENGTH OF NETTING OPINIONS	STATUS OF ISDA COLLATERAL OPINIONS	STRENGTH OF COLLATERAL OPINIONS
1	Australia	Adopted	Received	Clean	Received	Clean
2	Brunei Darussalam					
3	Canada	Adopted	Received	Clean	Received	Clean
4	Chile	Under Consideration	Received	Clean	Received	Clean
5	People's Republic of China					
6	Hong Kong, China		Received	Clean	Received	Clean
7	Indonesia		Received	Fairly Clean	Received	Unclean
8	Japan	Adopted	Received	Clean	Received	Clean
9	Republic of Korea	Adopted	Received	Fairly Clean	Received	Unclean
10	Malaysia		Received	Fairly Clean	Received	Unclean
11	Mexico	Adopted	Received	Clean	Received	Clean
12	New Zealand	Adopted	Received	Clean	Received	Clean
13	Papua New Guinea					
14	Peru	Adopted	Received	Fairly Clean		
15	The Philippines		Received	Fairly Clean	Received	Clean
16	Russia	Adopted	Commissioned			
17	Singapore		Received	Clean	Received	Clean
	Chinese Taipei		Received	Clean	Received	Clean
19	Thailand		Received	Clean	Received	Unclean
20	The United States	Adopted	Received	Clean	Received	Clean
21	Vietnam					

Sources: [www2.isda.org](http://www2.isda.org), netalytics&CSAnalytics, netting and collateral opinions from counsels of each country  
as of: 9-Jan-14