# Contents

4  
**A key to the Capital Markets Union turns slowly**  
A brief analysis of the proposed Securitisation Regulation and the related trilogue process

6  
**The FCA introduces a ban on right of first refusal clauses**  
A summary of the ban’s application and exemptions, following the FCA’s consultation on the prohibition of restrictive contractual clauses

8  
**Asia prepares for margining**  
An update on the new OTC derivatives margin rules for Australia, Hong Kong, Japan and Singapore

16  
**Appetite for Masala Bonds grows**  
Key features of Masala Bonds and the outlook for issuers

19  
**Portuguese courts consider the enforceability of derivatives**  
An overview of the Portuguese courts’ approach to assessing the validity and enforceability of derivatives contracts which are challenged on the grounds of public policy and the effect of choice-of-law clauses

21  
**California and Georgia disallow jury trial waivers**  
Alternatives to trial by jury for commercial lenders and related considerations for loan documentation

23  
**Dodd-Frank dismantled**  
An interview on the likely impact of the Trump administration’s vision for the US financial system

25  
**Interval funds allow for alternative strategies**  
A guide to US interval funds’ regulatory framework, formation and management

26  
**UAE issues new mortgage law**  
An analysis of the new UAE federal law on mortgaging moveable properties
Foreword

I am pleased to present our latest issue of Finance and Markets Global Insight (previously Global Financial Markets Insight). In this issue we pull together articles by our leading practitioners around the world, on finance and investment opportunities and issues that are emerging as markets evolve. We cover themes, products and practices which will frame the development of our clients’ businesses and future financial structures.

New markets continue to open, such as the growing Masala bond market which could provide a significant source of international capital for Indian businesses. In the UAE we see possibilities arising from a new federal law on mortgaging movable property.

In the funds arena we look at interval funds which allow managers to develop alternative investment strategies and investors to gain exposure to illiquid assets while providing liquidity on a periodic basis.

Major regulatory topics include the ongoing debate over the rules that should apply to the European securitisation market if it is to establish itself as a mainstream funding mechanism. We also consider the implications of the Trump administration’s proposals to reform elements of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

We examine the UK Financial Conduct Authority’s proposals to ban rights of first refusal, which would prevent banks from requiring their customers to offer them proposed mandates before accepting services from third-party providers. As California and Georgia both disallow jury-trial waivers, we highlight drafting considerations for commercial lenders who want to apply alternatives to jury trial.

In Portugal we assess judicial guidance for participants entering into derivatives trades with Portuguese entities. In Asia we chart the new OTC derivatives margining rules for Australia, Hong Kong, Japan and Singapore.

We hope that these articles offer useful insight into some of the many changes that are impacting international finance and investment markets; and we look forward to working with you to make the most of these opportunities or to address the challenges presented.

Martin Bartlam
International Group Head of Finance & Projects
DLA Piper
A key to the Capital Markets Union turns slowly

A brief analysis of the proposed Securitisation Regulation and the related trilogue process

In brief...
Reviving the largely moribund European securitisation market is key to the European Commission’s ambitious Capital Markets Union which was launched in September 2015. As the European Commission said at the time, securitisation can increase the availability of credit and reduce the cost of funding, contribute to a well-diversified funding base and act as an important risk-transfer tool to improve capital efficiency and allocate risk to match demand.

The proposed Securitisation Regulation would define and differentiate ‘simple, transparent and standardised’ (STS) products and related amendments to regulations such as those under the Capital Requirements Regulation (CRR) and Solvency II would give them relatively favourable capital adequacy treatment.

Trilogue progress and Brexit
The draft sent by the European Commission to the European Parliament was not perfect but what came back from the MEPs was badly mangled. In between the UK referendum moved the goalposts, raising questions over the central role of London and in turn potentially impacting on timing: it has been reported that some French and German participants are averse to an agreement being made on such an important aspect of the Capital Markets Union before there is an overall settlement about the shape of the post-Brexit EU-UK relationship. The ‘trilogue’ process now under way involves a series of meetings between the European Commission, representatives of the European Parliament, and the European Council (representing the 28 EU national governments and led by Malta until July, when Estonia takes over for the next six months) to find compromises.

We are following the process closely but given its inherent uncertainties, it is yet impossible to make sensible predictions about when any agreement will emerge, or what it might look like. It is clear that early hopes that we would have an agreement by now, with the new Securitisation Regulation becoming effective in 2018, were wide of the mark.

The major areas of dispute are well known. At the time of writing this article, there has been some movement in the form of non-papers but much remains up in the air. The big issues are as follows.

Risk retention
The industry, as indeed the European Commission and the European Banking Authority, are against moving away from the current Capital Requirements Regulation risk retention rules, which require a 5% retention which can be done in any of five different ways. Lead rapporteur Paul Tang’s point is that the ‘skin in the game’ represented by a horizontal first slice of 5% is considerably different from that represented by a vertical 5% – a view which has academic support from a February 2017 paper. It does however go against international market norms and the European Commission robustly rejected it in April; but that does not mean the point has gone away. Some elements of the industry could probably live with higher than 5%; in recent CLOs the retention has well exceeded this level but this has been done on a voluntary basis where it made economic sense, rather than being imposed by statute.

Capital calibration
The European Commission has indicated it will not propose amendments to Solvency II without agreement on STS first; and the risk is that the longer insurance investors stay out of the market, the longer it will take them to re-enter it even if reduced levels for STS (which include a floor risk weighting of 10% for STS which equates to the treatment of covered bonds) are eventually agreed.

Access to the market
As drafted, at least one of the originator, sponsor or original lender must be a regulated entity, lending or financial leasing institution, or a multilateral development bank. ‘Regulated entity’ includes – perhaps accidentally – recognised third-country investment firms. However, direct originators such as those with car loan and mobile phone receivables would be excluded; and it currently remains unknown whether or not the post-Brexit UK will be a recognised third country and, if so, when that recognition would be granted. The provision which would limit investment to institutional investors only is currently the subject of a non-paper suggesting its replacement with a ban on retail investors, which would avoid the obvious concentration of risk that would otherwise arise and permit EU corporate treasurers to buy asset-backed commercial paper (ABCP) direct, rather than forcing them into money market funds. To qualify for STS status, the draft Securitisation Regulation currently states that all three of the originator, sponsor and issuer must be established in either the EU or a recognised third country with an equivalent regulatory environment; but, as it is recognised
that this is a political issue, it will only be addressed in one of the later trilogues and the outcome remains uncertain at this stage.

**Transparency (investor name give up)**
Requiring the investor’s beneficial owner and holding to be publicly disclosed seems to be an ideological totem for many MEPs. However, it is counter-productive if the goal is to reinvigorate the market; and it is difficult to see how it could work for secondary market buyers or for ABCP. Another ‘bone of contention’ was whether the transparency rules will be relaxed for issues where there is no public prospectus, although it now seems that progress has been made on this score and a European Commission non-paper proposes that the European Securities and Markets Authority (ESMA) could propose regulatory technical standards to address the point. There remains doubt about where the disclosed details will be held – an issue where there is a considerable amount of detail to be worked through. It seems that ESMA currently lacks any budget for a centralised data repository (readers will remember that this surfaced back in April 2016 with the ill-fated ‘European Rating Platform’).

**Existing deals**
The extent of available grandfathering for existing deals which are essentially STS but fail on a technicality remains to be clarified (although this would seem capable of being refined in a sensible way once the dust settles on the main political points). This raises a concern for deals now being done that might need some refinement to become STS in the future. The benefits of raising an existing deal to STS status should encourage investors to vote in favour of the necessary amendments where the changes are essentially minor — but in any event, many deals allow the trustee to consent to changes to accommodate a change to STS and the costs are covered as administrative expenses in the deal.

**Sanctions for breach**
As drafted, sanctions for breach apply not only to dishonesty or negligence but to inadvertent breaches of the legislation. However, since they will be set by EU member states, there is probably enough flexibility for national regulators to adjust them to reflect the degree of culpability. Against the background of perceived abuses in the pre-2007 market, we would not be surprised if MEPs remained resolute on this principle.

**CRR**
The proposed changes to the CRR amendment regulation are by contrast few and generally favourable (the technical nature of the CRR possibly having deterred MEPs). Covered bonds would still be treated favourably in EU banking regulation, particularly regarding liquidity and the Bank Recovery and Resolution Directive (covered bonds are exempt from bail-in) but the proposed 10% risk weighting floor for the highest ranked tranche of an STS issue would equate to that for covered bonds.

**Post trilogues**
There are many secondary issues and points of detail to be worked through once the trilogues conclude (for which the timescale is uncertain, although Malta would prefer something to be finalised by the end of its presidency and at the time of writing the final scheduled one is 15 June 2017).

That would not be the end of the matter though, even without the complicating factor of how this will relate to the Brexit negotiations; and once we have a finalised Securitisation Regulation, much delegated legislation in the form of regulatory technical standards will occupy the following 12 months.

Optimists may originally have hoped that the new STS regime would be in place and operating by 2018; pessimists may now be pencilling in 2020. As for the big question — whether what is produced will revive securitisation in Europe – we simply cannot know at this stage. We will undoubtedly have to return to this topic in future editions of Finance and Markets Global Insight.
The FCA introduces a ban on right of first refusal clauses

A summary of the ban’s application and exemptions, following the FCA’s consultation on the prohibition of restrictive contractual clauses

In brief...
In May 2015, the Financial Conduct Authority (FCA) launched a market study on investment and corporate banking services to consider issues including choice of banks and advisers for clients and the bundling and cross-subsidisation of services.

In October 2016, the FCA published its final report on the market study and a consultation paper on the prohibition of restrictive contractual clauses.

The FCA has proposed certain measures including a ban on contractual clauses that restrict competition without being clearly beneficial to clients.

The proposed ban
The ban would prohibit the use of two commonly used forms of restriction:

■ ‘Right of first refusal’ clauses – These prevent clients from accepting a third-party offer to provide future services unless they have first offered the mandate to the bank or broker on the terms proposed by the third party.

■ ‘Right to act’ clauses – These prevent clients from sourcing future services from third parties, regardless of any potential third-party offers.

Why it is being introduced
According to the FCA, these restrictive contractual clauses reduce a client’s choice, restrict their bargaining power and can provide the financial institution with an effective monopoly over all of that particular client’s financing arrangements. The FCA believes that the ban will encourage banks to compete on merit while providing clients with a broader range of financing options, more competitive terms and a less pressurised environment in which to select its preferred provider.

While it is conceivable that the promise of an engagement to provide future services could lead to lower fees on the initial engagement, the FCA determined that it was provided with no evidence that right of first refusal clauses benefit clients in any way. In the FCA’s view the banks should not need to rely on a contractual obligation to provide future services to build relationships. The FCA believes that the expectation of repeat work based on client satisfaction should be an incentive in itself and as a result there is no justification for allowing this practice to continue in the market.

Exemptions
In its October 2016 consultation paper the FCA proposed that any exclusions from the ban would be limited to bridging facilities. A bank would be unlikely to provide a bridging loan if it could not rely on the client returning to it for the longer term financing (typically in the form of a bond issue, equity issue or term loan). This exemption is also intended to cover warehouse facilities, on the basis that they are also designed to provide relatively short-term financing with both parties assuming that the original facility will be refinanced by way of a capital markets transaction.

The FCA has clarified that the ban will not apply to clauses that give a particular institution a ‘right to pitch’ for a particular transaction or a ‘right to match’ a proposal provided by an alternative financier. The ban will only extend to cover clauses that give a bank a right to provide future services; it will not apply to existing arrangements. Any clause aimed at recovering fees for work already undertaken would also fall outside the proposed ban.

The prohibition is to apply only to contracts or engagement letters entered into after the commencement of the rule. It would not apply to existing contracts or engagement letters.

Geographic scope
The FCA confirmed in its consultation paper that the prohibition covers future corporate finance services carried out from an establishment in the UK, regardless of the client’s location or the legal entity to which the activity is booked for accounting purposes. This means that the prohibition:

■ will not affect services provided to UK-based clients by banks located outside the UK; and

■ will affect services provided from banks’ UK establishments to non-UK based clients.
Next steps
The FCA has already proposed changes to the Code of Business Sourcebook to implement the ban and it is now due to publish a policy statement confirming any final changes. This is due in Q2 2017.

At various stages of the process market participants have raised objections to the FCA’s proposals and concerns about how they would be implemented. We await the FCA’s final policy statement with interest to see whether any late changes are introduced.

In any event, once the terms of the ban are confirmed, investment and corporate banks as well as their clients will need to consider the final policy statement carefully and assess whether changes are required to their standard form engagement letters and other contracts.

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Asia prepares for margining
An update on the new OTC derivatives margin rules for Australia, Hong Kong, Japan and Singapore

In brief...
As part of a global initiative regulating the posting of initial and variation margin when trading non-cleared OTC derivatives, new margin rules are now in effect for Australia, Hong Kong, Japan and Singapore. 1 March 2017 was the key global implementation date for variation margin.

For more information on the new margin rules for Europe, please refer to our previous articles published in Global Financial Markets Insight issues 8 (November 2015), 10 (July 2016) and 11 (December 2016).

The substance of this article was first published in Regulatory Intelligence by Thomson Reuters.

International regulatory framework
New regulations and guidelines have been adopted in Asia which require the margining of non-cleared over-the-counter (OTC) derivatives. These new margin rules need to be considered in conjunction with the international regulatory framework for non-cleared OTC derivatives: namely, in March 2015, a final policy framework for margin requirements for non-centrally cleared derivatives was set up by the International Organization of Securities Commissions (IOSCO) and the Basel Committee on Banking Supervisions (BCBS) (the International Policy Framework). This international structure served as a framework for the relevant regulators for each jurisdiction. For instance, for Europe, while the overarching principles for margining trades were established under the European Market Infrastructure Regulation (EU) No 648/2012 (EMIR), the implementation detail was separately developed under the Regulatory Technical Standards on risk-mitigation techniques (the RTS), and the European Supervisory Authorities followed the International Policy Framework in drafting these RTS.

The new global margin rules address the posting of both initial margin (IM) (referred to as the Independent Amount under the ISDA collateral documentation) and variation margin (VM), including the:

- amount of IM and VM that counterparties should post and collect;
- methodologies to be used for calculating the requisite amounts;
- timings for posting; and
- eligibility criteria for the types of collateral than can be posted.

International implementation timeline
Further, the International Policy Framework set out a timeline for the implementation of the new margin rules, and (as illustrated in the table overleaf) the regulatory authorities for each of Australia, Hong Kong, Japan and Singapore have been careful to ensure compliance with this global implementation timeline. The key implementation date for VM was 1 March 2017 while the International Policy Framework proposed a phased-in implementation approach for IM dependent on a counterparty’s uncleared OTC derivatives book.

Key margin rules for Asia
There follows a brief overview of some of the key margin rules and their application for each of Australia, Hong Kong, Japan and Singapore.
<table>
<thead>
<tr>
<th>Country</th>
<th>Australia</th>
<th>Hong Kong</th>
<th>Japan</th>
<th>Singapore</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Overview – regulators</strong></td>
<td>Australian Prudential Regulation Authority (APRA)</td>
<td>Hong Kong Monetary Authority (HKMA)</td>
<td>Japanese Financial Services Agency (JFSA)</td>
<td>Monetary Authority of Singapore (MAS)</td>
</tr>
<tr>
<td><strong>Overview – ‘Covered Margin Regime’ – ISDA Variation Margin Protocol</strong></td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td><strong>Timings – Initial Margin (IM) timings</strong></td>
<td>Phase-in compliance beginning 1 March 2017 (for counter parties (CPs) with AANA exceeding AUD4.5 trillion); otherwise 1 September 2017 yearly through to 1 September 2020</td>
<td>Phase-in compliance beginning 1 March 2017 (for CPs with AANA exceeding HK$24 trillion), subject to a six-month transitional period; otherwise 1 September 2017 through to 1 September 2020</td>
<td>Phase-in compliance beginning 1 September 2016 (for CPs with AANA exceeding JPY420 trillion); otherwise 1 September 2017 yearly through to 1 September 2020</td>
<td>Phase-in compliance beginning 1 March 2017 (for CPs with AANA exceeding S$4.8 trillion), subject to a six-month transitional period, otherwise 1 September 2017 through to 1 September 2020</td>
</tr>
<tr>
<td><strong>Timings – Variation Margin (VM) timings</strong></td>
<td>1 March 2017 (all CPs with AANA exceeding AUD3 billion), subject to a six-month transitional period</td>
<td>1 March 2017 (all CPs), subject to a six-month transitional period</td>
<td>1 September 2016 (for CPs with AANA exceeding JPY420 trillion), and 1 March 2017 for all other CPs</td>
<td>1 March 2017 (all CPs), subject to a six-month transitional period</td>
</tr>
</tbody>
</table>

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1. The average of the total gross notional amount of all uncleared OTC derivatives of an entity, calculated across its group, recorded on the last business day of the months March, April and May of the relevant year.
### Application – in-scope CPs

**APRA covered entities include:**
- Authorised Deposit-Taking Institutions (ADIs), being foreign ADI and non-operating holding companies (NOHCs) authorised under the Banking Act;
- general insurers being Category C insurers, NOHCs authorised under the Insurance Act;
- life companies being friendly societies and eligible foreign life insurance companies (EFLIC) and NOHCs authorised under the Life Insurance Act; and
- registerable superannuation entities authorised under the SIS Act.

‘Covered entities’ include:
- certain financial counterparties (not limited to ‘authorised institutions’ authorised by the HKMA, corporations licensed by the HK Securities and Futures Commission for certain regulated activities and collective investment schemes) which have AANA of non-centrally cleared derivatives exceeding HK$15 billion; and
- significant non-financial counterparties, which are not exempt entities.

In-scope CPs include:
- ‘Financial Instrument Dealers’ which conduct Type I Financial Instruments Businesses, defined under Art. 28, Paragraph 1 of the Financial Instruments and Exchange Act; or

In-scope CPs include:
- Licensed Banks under the Banking Act; and
- merchant banks approved under the Monetary Authority of Singapore Act with AANA exceeding S$5 billion.

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2 Significant non-financial counterparties are entities other than financial counterparties which have (either on an individual or a group basis) an AANA of non-centrally cleared derivatives exceeding HK$60 billion.
Australia | Hong Kong | Japan | Singapore
---|---|---|---
**Application – exempt entities**

**Non-financial institutions** are excluded from ‘covered counterparty’ definition.

The following entities are excluded from the ‘covered counterparty’ definition (whether or not financial institutions):

- sovereigns, central, multilateral development banks, public sector entities and the Bank for International Settlements; and
- certain covered bond, securitisation and real estate/infrastructure SPVs that enter into derivative transactions for the sole purpose of hedging.

Exemptions apply for intra-group transactions.

**Exemptions apply for:**

- sovereigns, central banks, public sector entities, multilateral development banks and the Bank for International Settlements;
- intra-group transactions (but HKMA has the authority to bring them into scope); and
- special purpose entities are excluded if they are transacting for the sole purpose of hedging.

Exemptions apply for intra-group transactions.

**Exemptions apply for:**

- Singapore government;
- statutory bodies;
- central banks;
- central government;
- any agency (of a central government in a jurisdiction other than Singapore) that is incorporated or established for a non-commercial purpose; and
- multilateral agencies, organisations and entities.

Exemptions apply for:

- Singapore government;
- statutory bodies;
- central banks;
- central government;
- any agency (of a central government in a jurisdiction other than Singapore) that is incorporated or established for a non-commercial purpose; and
- multilateral agencies, organisations and entities.
<table>
<thead>
<tr>
<th>Australia</th>
<th>Hong Kong</th>
<th>Japan</th>
<th>Singapore</th>
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<tbody>
<tr>
<td><strong>Application – in-scope products</strong></td>
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<tr>
<td>OTC derivatives are not centrally cleared by a qualifying CCP.</td>
<td>OTC derivatives are not centrally cleared.</td>
<td>OTC derivatives are not centrally cleared by:</td>
<td>OTC derivatives (booked in Singapore) are not centrally cleared by a qualifying CCP.</td>
</tr>
<tr>
<td>Certain exemptions apply for physically-settled FX forwards and swaps (including cross-currency swaps).</td>
<td>Certain exemptions apply for:</td>
<td></td>
<td></td>
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<tr>
<td>■ physically-settled forwards and FX swaps (including cross-currency swaps);</td>
<td>■ a local or overseas CCP licensed in Japan; or</td>
<td></td>
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<tr>
<td>■ physically-settled commodity forwards;</td>
<td>■ an overseas CCP, which offers clearing services relying on exemptions from licensing requirements in Japan.</td>
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<tr>
<td>■ repurchase agreements and securities lending transactions; and</td>
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<tr>
<td>■ indirectly cleared derivatives (provided they are intermediated through a clearing member on behalf of a non-member).</td>
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<td>Australia</td>
<td>Hong Kong</td>
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<tr>
<td><strong>Application – substituted compliance</strong></td>
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</table>

**APRA may approve cross-border compliance where the other jurisdiction’s comparable margin requirements apply.**

CP must (a) transact with a CP subject to the margin requirements of the relevant jurisdiction and/or (b) be directly subject to the margin requirements of the relevant jurisdiction.

Where a foreign ADI, Cat. C insurer or EFLIC is directly subject to margin/risk mitigation requirements that are substantially similar to BCBS-IOSCO framework/IOSCO’s Risk Mitigation Standards, it may comply with its home jurisdiction’s requirements where they have completed an internal assessment. Such assessment must be made available to APRA upon request.

There is no requirement to post IM where CP is trading with an entity within a jurisdiction that does not permit it or trading partner to comply with rules on IM holding.

There is no requirement to post VM where a CP is trading with an entity within a jurisdiction where there is doubt about enforceability of netting agreements.

**Substituted compliance is permitted to cross-border transactions with (a) a deemed comparable jurisdiction until such time as a comparability assessment has been completed for that jurisdiction or (b) a jurisdiction for which the HKMA has issued a comparability determination (provided that the margin requirements of such jurisdiction are complied with in their entirety).**

CPs will be exempted if they comply with an equivalent overseas regime designated by the JFSA Commissioner.

There is deemed cross-border compliance where the other jurisdiction’s margin requirements apply. CP must either (a) have complied with the other jurisdiction’s requirements which are comparable to Singapore or (b) has complied with comparable margin requirements imposed on its foreign CP.
Collateral – eligible collateral and applicable haircuts

<table>
<thead>
<tr>
<th>Australia</th>
<th>Hong Kong</th>
<th>Japan</th>
<th>Singapore</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash – 0%</td>
<td>Cash – 0%</td>
<td>Cash – 0%</td>
<td>Cash – 0%</td>
</tr>
<tr>
<td>Gold – 15%</td>
<td>Gold – 15%</td>
<td>Gold – 15%</td>
<td>Gold – 15%</td>
</tr>
<tr>
<td>Government, central banks, international banking agencies and multilateral development banks Bonds (rated 4+) – 0.5-4%</td>
<td>Government, multilateral development bank, or public sector entity bonds (rated 3+) – 0.5-6%</td>
<td>Government and multinational bank bonds – 0.5-15%</td>
<td>Central bank and government bonds – 0.5-15%</td>
</tr>
<tr>
<td>ADI, overseas banks, government and corporate bonds (rated 3+) – 1-8%</td>
<td>Other publicly traded bonds (rated 3+) – 1-12%</td>
<td>Corporate bonds – 1-12%</td>
<td>Other issuers – 1-15%</td>
</tr>
<tr>
<td>ADI or overseas bank Bonds (not rated) – 1-8%</td>
<td>Shares – 15%</td>
<td>Shares – 15%</td>
<td>Financial institutions – 20%</td>
</tr>
<tr>
<td>Covered bonds (rated 3+) – 1-8%</td>
<td>Further 8% haircut will apply for currency ‘mis-match’ between currency of original collateral and settlement collateral</td>
<td>Further 8% will apply for currency ‘mis-match’ between currency of original collateral and settlement collateral</td>
<td>Any unit in a collective investment scheme – higher of 25% or the highest haircut available to any security which the fund can invest in</td>
</tr>
<tr>
<td>Senior securitization exposures (rated 1+) – 1-8%</td>
<td></td>
<td></td>
<td>Further 8% will apply for currency ‘mis-match’ between currency of original collateral and settlement collateral</td>
</tr>
<tr>
<td>Shares (including in a major stock index) – 15%</td>
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</tbody>
</table>

Collateral – Minimum Transfer Amounts (MTA)

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<tr>
<th>Australia</th>
<th>Hong Kong</th>
<th>Japan</th>
<th>Singapore</th>
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</thead>
<tbody>
<tr>
<td>The combined MTA amount for IM and VM may not exceed AUD750,000.</td>
<td>The combined MTA amount for IM and VM may not exceed HK$3.75 million.</td>
<td>The combined MTA amount for IM and VM may not exceed JPY70 million.</td>
<td>The combined MTA amount for IM and VM may not exceed S$800,000.</td>
</tr>
</tbody>
</table>

Collateral – thresholds

<table>
<thead>
<tr>
<th>IM – AUD75 million</th>
<th>IM – HK$375 million</th>
<th>IM – JPY7 billion</th>
<th>IM – S$80 million</th>
</tr>
</thead>
</table>

Collateral – transfer timings (VM only)

| VM must be calculated and called on a daily basis. | Must be called T+1 and collected no later than two business days thereafter | Must be collected without delay, to the extent practically possible, after the margin call | Must be collected T+3 |

**NB** DLA Piper is not permitted (or otherwise able) to advise on local laws for all the jurisdictions covered by this article: appropriate local legal advice should be taken if any of your non-cleared OTC derivatives trades are in scope with respect to any of these new regulations.
Appetite for Masala Bonds grows

Key features of Masala Bonds and the outlook for issuers

In brief...
Borrowing by Indian companies from the overseas market or ‘External Commercial Borrowings’ (commonly referred to as ECBs), is regulated by the Reserve Bank of India (RBI) and is governed by the various rules specified by the RBI.

Until recently, the ability of Indian companies to borrow from the overseas markets was predominantly limited to foreign currencies. The RBI issued its A.P. (DIR Series) Circular No. 17 on 29 September 2015 (the Rupee Bond Guidelines) which allowed Indian companies to raise funding through the issuance of Rupee-denominated debt instruments – which are now widely referred to as ‘Masala Bonds’.

The Rupee Bond Guidelines have increased the ability of Indian issuers to access the international debt capital markets and thereby have potentially opened up another avenue for Indian issuers to seek competitively priced funding from the international markets. Similarly, the Rupee Bond Guidelines have allowed foreign fixed income investors the first real opportunity to have exposure to the Indian Rupee, which has been enjoying a lower volatility lately compared to other Asian currencies.

This article outlines some key features of Masala Bonds and the outlook for issuers.

NB However, please note that Indian regulations do not permit foreign law firms to advise on Indian law. This article is based on our discussions with Indian counsel, our understanding of Indian regulation and our experience of working on Indian-related transactions.

Issuers

The Rupee Bond Guidelines have allowed a greater universe of issuers to issue Masala Bonds. In addition to companies (as was previously the case), any ‘body corporate’, non-bank financial company, real estate investment trust and infrastructure investment trust which is subject to the regulatory oversight of the Securities and Exchange Board of India (SEBI) is also eligible to issue Masala Bonds.

Indian banks will also be eligible to issue Masala Bonds for the purposes of financing infrastructure and affordable housing, subject to conforming to the guidelines issued by the RBI.

Use of proceeds

The proceeds of a Masala Bond issue can be used by the issuer for all purposes except for:

- real estate activities (including acquisition of land) except development of integrated townships or affordable housing projects;
- investment in capital markets (including domestic Indian equity investments);
- activities otherwise prohibited under the existing ‘foreign direct investment’ regulatory framework; and
- on-lending to other entities for the purposes of any of the preceding restricted uses.

Markets

Masala Bonds can only be issued in a jurisdiction and can only be subscribed by a resident of a country:

- which is a member of Financial Action Task Force (FATF) or a FATF-Style Regional Body;
- whose securities market regulator is a signatory to the International Organization of Securities Commissions’ (IOSCO’s) Multilateral Memorandum of Understanding (MOU) or to bilateral MOU with the SEBI for information sharing arrangements; and
- should not be a country identified in the public statement of the FATF as a jurisdiction having anti-money laundering or terrorism financing deficiencies or a jurisdiction that has not made sufficient progress in addressing those deficiencies.

Further, multilateral and regional financial institutions where India is a member country can also be investors in Masala Bonds.

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1 The Rupee Bond Guidelines for the purposes of this article also include the update to the Rupee Bond Guidelines issued by the RBI on 13 April 2016.
2 The Companies Act 2013 includes a cooperative society within the definition of ‘body corporate’.
The Masala Bonds should also be ‘plain vanilla bonds’. What does not constitute ‘plain vanilla bonds’ is not clear at present, as the term is not defined in the Rupee Bond Guidelines.

Pricing parameters
The Rupee Bond Guidelines prescribe a minimum maturity of three years with prepayment (whether voluntary or mandatory) possible only after the three years from the date of issuance.

The maximum amount which can be borrowed by an entity by issuance of Masala Bonds is ₹50 billion (approximately US$750 million). Any increase in the issue size beyond ₹50 billion in a financial year will require the prior approval of the RBI. In relation to the pricing of Masala Bonds the Rupee Bond Guidelines provide that the ‘all-in costs’ of an issuance should be commensurate to the ‘prevailing market conditions’. There is a lack of clarity as to what this means. In any event, it is expected that once a market develops for Masala Bonds, the RBI may revisit this all-in cost ceiling.

In addition to the all-in cost ceiling, the rate of conversion that will apply between the Indian Rupee and the foreign currency in which the Masala Bond will settle and trade will be the prevailing rate at the time any payment is being made on the bonds – thereby shifting the currency risk onto the investors. This feature will have consequences on pricing as investors will want to factor any currency volatility into the price of Masala Bonds.

Tax treatment
Consistent with the tax treatment of bonds issued by Indian issuers, a withholding tax of 5% is exigible on interest income. This concessional rate was initially only available until 30 June 2017, but in the Union Budget for 2017-18, the Finance Minister extended this concessional rate to June 2020. An additional tax benefit has been extended to Masala Bonds with the Union Budget for 2017-18 proposing to exempt them from taxation for transfers between non-residents.

In order to provide relief in respect of gains arising on account of appreciation of the Indian Rupee against a foreign currency at the time of redemption of Masala Bonds to secondary holders, the Indian government has indicated its intention to amend the Income Tax Act. The proposed amendment would be effected to ensure that the appreciation of the Indian Rupee will be ignored for the purposes of computation of the full value of consideration.

Outlook
The publication of the Rupee Bonds Guidelines certainly provides an avenue for a vast variety of issuers to raise capital from the international debt markets. Provided that the cost of borrowing onshore is higher than the pricing of the Masala Bonds, it would certainly be of interest to Indian companies who wish to raise financing at a lower cost. Equally, given the relatively high cost of borrowing onshore in India, especially for smaller mid-cap companies, there is the expectation that even an aggressively-priced bond may appear palatable to both investors and the issuer alike. There is also the need for fund raising to address India’s infrastructure needs, which Masala Bonds may address if a robust market develops for these bonds. Also, given the regulatory restrictions which limit their ability to accept deposits, it is expected that Indian non-bank finance companies may look towards the international debt capital markets to address their funding requirements.

To conclude, the advent of Masala Bonds may herald a new phase in investor appetite to participate in one of the world’s fastest growing economies.

Indian Rupee Bonds on the Main Market of the London Stock Exchange
As of February 2017, 30 Masala Bonds are listed on the London Stock Exchange with a combined outstanding value of US$3.5 billion.* Some of the notable transactions are listed overleaf.

* Source: London Stock Exchange Masala Bonds List (March 2017)
<table>
<thead>
<tr>
<th>Issuer</th>
<th>Issue Date</th>
<th>Amount (₹ billions)</th>
<th>Coupon (%)</th>
<th>Tenor (years)</th>
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<td>6.6</td>
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In brief...
Within the last few years, derivatives have been under scrutiny by Portuguese courts, affecting not only derivatives entered into under agreements subject to local law, but also derivatives subject to International Swaps and Derivatives Association (ISDA) Master Agreements. Such court decisions have been, in many cases, contradictory and surprising – and have included decisions accepting derivatives as legal financial instruments and others nullifying derivatives on the basis that they are contrary to public order.

Although in Portugal, as a civil law jurisdiction, there is no rule of precedent, past court decisions may be referenced in future cases. Portuguese court decisions concerning derivatives should be considered by anyone who is entering into a derivative with a Portuguese counterparty.

Background
Since the global financial crisis in 2008 which reached its peak with the bankruptcy of Lehman Brothers and the sovereign debt crisis which followed and which had a huge impact across southern Europe, including Portugal, the status of certain financial instruments has been challenged. Derivatives have been no exception and in Portugal they have been widely discussed, both by the public and in the courts.

The pressure to reduce public-budget expenditure and the involvement of public companies in complex derivative structures exposed the ‘malicious’ effects of derivatives – in particular, in cases where such derivatives were not simply being entered into in order to hedge an exposure.

Within this context – and with the lack of liquidity in the market and high default rates – counterparties to derivative agreements felt encouraged to challenge the validity of derivatives or of certain clauses of the derivative agreements.

Court decisions
The court decisions around derivatives (and for these purposes we are only considering superior court decisions) have addressed several different related matters. However, for the purposes of this article we will only consider the ones which could affect agreements with a cross-border scope – the validity of derivatives under Portuguese law and the validity of choice of law and jurisdiction.

Validity
The validity of derivatives under Portuguese law has been discussed from many different angles. Derivatives, in particular when they do not have a hedging nature and are purely speculative, may be deemed as aleatory contracts (deemed tantamount to gambling). This, according to Portuguese law would not affect the validity of the contract but only its enforceability as it would only create natural (non-binding) obligations of the parties. Thus, a creditor under such an agreement would not be entitled to claim any due amounts in court. However, the Portuguese Supreme Court took a step further (Decision of the Portuguese Supreme Court under case 531/11.7TVLSB. L1.S1) and also understood that such derivatives with a speculative nature would be in breach of Portuguese constitutional principles such as the principles of economic politics of fighting speculative trade; and therefore, as they were in violation of Portuguese public policy, they would be null and void. Furthermore, because the relevant rules are rules of public policy, the enforcement in Portugal of foreign court decisions for the payment of derivatives entered into under ISDA agreements could be challenged on the same grounds.

The Portuguese Supreme Court has since ruled on other decisions accepting derivatives as legal and valid agreements under Portuguese law; such decisions were taken on the basis that derivatives are admissible under EU legislation such as the Markets in Financial Instruments Directive (2004/39/EC) which is fully transposed in Portugal.

Currently the majority of decisions in the Portuguese Supreme Court accept derivatives as legal and valid agreements. However, there is still no formal decision of the Portuguese Supreme Court with a common understanding from the court, which means that there is always the risk of future decisions ruling on the nullity of derivative agreements.

Choice of law and jurisdiction
Another matter that has been widely discussed in the Portuguese courts in respect of ISDA agreements is choice of law and jurisdiction.

Essentially, small and medium companies who entered into derivatives contracts subject to ISDA agreements have been challenging the choice of law and jurisdiction clauses citing the legal framework applicable to general terms and conditions agreements (LFGTC). The LFGTC...
has mandatory rules of public policy according to which clauses of general terms and conditions imposing a certain jurisdiction which causes serious constraints to the other party should be deemed null and void. Generally a clause under which a bank could force a small or medium company in Portugal to determine the validity or breach of an agreement outside of Portugal – and in the case of ISDA agreements, either in England or New York – would be within the scope of such provision of law and thus deemed null and void.

The courts have understood that applicable EU regulations (Regulation no. 44/2001) would supersede such rules of public policy of the LFGTC; and, therefore, the choices of law and jurisdiction should be upheld. However, it is important to note that in all related court decisions the party challenging the choice of law and jurisdiction clause was not able to bring sufficient evidence that the ISDA agreement in discussion was in fact a general terms and conditions agreement. In those cases the parties have negotiated and elected in a schedule the applicable provisions of the ISDA Master Agreement and, thus, should be deemed as an agreement negotiated between parties. This means that, technically, the LFGTC was not the appropriate grounds on which to bring an action. Accordingly, one should not exclude the possibility of having a different court decision in future, stating that the rules of public policy of the LFGTC supersede the applicable EU regulations.

Conclusions
In summary, considering the matters outlined above, the following risks should be considered:

- Derivatives entered either under agreements subject to Portuguese law or the law of other jurisdictions (as would be the case for ISDA agreements) may be deemed null and void, if they have a speculative nature — and the enforcement in Portugal of such derivatives could also be challenged on the basis of the breach of such rules of public policy.

- Derivatives entered under ISDA Master Agreements may be deemed subject to Portuguese jurisdiction.

In view of the above, parties who have entered into derivative agreements of a speculative nature with Portuguese parties should carefully assess the credit risks of their clients; and if they are using ISDA agreements, then it is advisable to request from the other party collateral under an adequate credit support annex. Still, in the negotiation of ISDA Master Agreements it is important that schedules are negotiated and entered between the parties in order to avoid that such agreements are qualified as an agreement of general terms and conditions that could be subject to the rules of public policy of the LFGTC.

As a final note, it is also important to stress that although we can find within the last few years some Portuguese court decisions that may seem surprising, such court cases are useful. They have allowed the courts and judges in Portugal to become acquainted with a financial product relatively uncovered by Portuguese law standards (and about which there were few past court cases): derivatives. On that basis, it is fair to say that today Portuguese courts and judges are better equipped to review and rule on such derivatives cases.

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California and Georgia disallow jury trial waivers

Alternatives to trial by jury for commercial lenders and related considerations for loan documentation

In brief...
Commercial lenders tend to perceive jury trials as disadvantageous when resolving conflicts between them and their borrowers. Alternative dispute resolution, such as binding arbitration, has proved to be an unsatisfactory substitute. The preferable method for avoiding a jury trial is for both parties to expressly waive their right to a jury trial in the relevant loan documents (ie before the dispute arises). However, in the US, the states of California and Georgia do not permit such waivers. Accordingly, when advising lenders who are lending in California or Georgia, lender’s counsel should ensure that loan documents provide for appropriate choice of law and exclusive venue provisions (specifying a different state that enforces pre-dispute contractual jury waivers) and, in California, a judicial reference provision.

Alternatives to trial by jury
For many commercial lenders, it is difficult to imagine a less appealing mechanism for adjudicating disputes arising out of its commercial contracts than trial by jury. Lenders often seek ways to avoid jury trials because jurors are generally perceived to be biased against large institutions and corporations and to lack the expertise and competency to deliberate complex commercial cases. When awarding damages, juries are thought to be more capricious than a judge.

One alternative that has been employed as a means to circumvent a trial by jury is binding arbitration. Lenders, however, have found resolution by arbitration to be less than ideal because the arbitrator is not required to follow the law or applicable evidentiary standards, third-party discovery can be difficult to enforce and the arbitrator’s decision is not easily appealable. One preferable method that is used to avoid jury trials is the inclusion of pre-dispute jury waiver provisions in loan documents. While nearly every state’s constitution guarantees the right to a civic jury trial, each state may enact legislation to allow parties to specifically waive that right, both pre- and post-dispute, thus compelling a proceeding in which the judge is the finder of fact. Two states, however, California and Georgia, do not permit pre-dispute jury trial waivers.

A recent California case, Rincon EV Realty LLC v. CP III Rincon Towers, Inc., 8 Cal. App. 5th 1, 213 Cal. Rptr. 3d 410 (Ct. App. 2017), serves to highlight this issue.

Waiver of trial by jury
Under a pre-dispute contractual jury waiver, the parties to a commercial contract expressly waive their respective rights to a jury trial at the time they enter into the contract. Accordingly, assuming the enforceability of such a provision, the lender is afforded the opportunity to resolve controversies in the state or federal judicial system by means of a bench trial exclusively, subject to the familiar procedural and evidentiary rules of litigation, without the need to resort to less Certain alternative dispute resolution. Provided that the waiver is entered into knowingly and voluntarily, pre-dispute contractual jury waivers are presumably enforceable and generally upheld in federal courts and in the state courts that have reviewed the issue— with two notable exceptions.

Both California and Georgia have expressly held pre-dispute contractual jury waivers in civil actions unenforceable on statutory and public policy grounds. Georgia’s constitution guarantees the right to a jury trial while its jury waiver statute, Georgia Code of Civil Practice § 9-11-39(a), lists the limited circumstances in which a party may waive that right. In Bank South, N.A. v. Howard, 264 Ga. 339, 444 S.E.2d 799 (1994), the Supreme Court of Georgia held that, because neither its constitution nor governing statute specifically provides for pre-dispute jury waivers, such waivers are unenforceable under Georgia law. Similarly, the California Supreme Court in Grafton Partners L.P. v. Superior Court, 36 Cal. 4th 944, 116 P.3d 479 (2005), held that pre-dispute jury waivers were not authorized by either its constitution or its jury waiver statute (California Code of Civil Procedure § 631), and thus are unenforceable under California law.

Choice of law and exclusive venue provisions
Commercial loan documents typically provide that such documents, and any litigation arising out of the subject transaction, will be governed by the law of a specified state. Such provisions (for example, the selection of New York law to govern the documents) can be enforceable under certain conditions in Georgia and California but have not been useful in evading the pre-dispute jury waiver bans in California and would likely not be any more efficacious in Georgia. The argument advanced by the party attempting to enforce the jury trial waiver is that the court applying, for example, New York law should uphold the waiver because such waivers are enforceable under New York law.
These arguments have proved unsuccessful in California. In the vein of Grafton Partners, the Rincon case recently affirmed California’s resistance to jury trial waivers with a focus on relevant choice of law provisions in the document that is the subject of enforcement. Rincon made clear that in California, or at least in its First Appellate District, pre-dispute contractual jury waivers are unenforceable despite inclusion of a choice-of-law provision construing the contract under the laws of a state that enforces such waivers. In Rincon, the court found that even when applying the law of another state when adjudicating a case, pre-dispute contractual jury waivers are contrary to California public policy and, therefore, cannot be enforced. Similarly, under Georgia’s conflict-of-laws principles, a party may not seek to apply the law of another state if such law would contravene Georgia’s fundamental public policy. In light of the foregoing, lenders should make efforts, where possible, from bringing cases in California or Georgia by granting the lender broad choice of venue options in the loan documents. This can be accomplished by providing in the documents that any litigation arising under the loan documents shall be instituted in a specified state (that is, a state in which pre-dispute contractual jury waivers are enforced).

**Judicial reference**
California offers another option for lenders endeavoring to avoid jury trials by permitting the parties to transfer litigation to a referee. The referee, who is appointed by either the parties or the court, will adjudicate the dispute in accordance with the law, including applicable evidentiary rules. The proceeding will be conducted, essentially, in the same manner as a bench trial, resolved by an expert who will also be the finder of fact. Significantly, unlike arbitration, the referee’s decision, while enforceable, is appealable by the non-prevailing party. By including a ‘judicial reference’ provision in the loan documents, the parties agree, pre-dispute, to the appointment of a referee to decide controversies among the parties. However, judicial reference provisions in mortgage documents should preserve the lender’s right to initiate judicial or non-judicial foreclosures, seek interim remedies, and exercise the right of power of sale.

**Conclusion**
When drafting loan documents on behalf of commercial lenders, lawyers should be mindful of their clients’ interest in avoiding jury trials. Loan documents should include, at the very least, the following provisions:
- a non-California or non-Georgia choice of law provision and an exclusive venue provision selecting a state which enforces pre-dispute contractual jury waivers; and
- in California, a carefully tailored judicial reference provision.

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In brief …
Less than a month into his presidency and Donald Trump has already started the process of dismantling the Dodd-Frank Wall Street Reform and Consumer Protection Act, introduced as a response to the global financial crisis of 2008–09. Interviewed by Jenny Rayner, DLA Piper partners Michael McKee (London) and Jeff Hare (Washington DC) consider the likely impact of the Trump administration’s vision for the US financial system.

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Why has Dodd-Frank been thrust back into the spotlight since President Trump’s inauguration?
It is fair to say that neither Presidential candidate positioned themselves as particularly ‘pro-bank’, but, unlike Clinton, Trump was quite critical of regulatory burdens imposed by Dodd-Frank which he believed were slowing economic growth. He referred to Dodd-Frank as a ‘disaster’. While specifics were lacking, Trump’s transition team announced before his inauguration that the administration ‘will be working to dismantle the Dodd-Frank Act and replace it with new policies to encourage economic growth and job creation’.

How is Trump’s executive order for financial services likely to affect the post-crisis reforms introduced by Dodd-Frank in the US?
On Friday, 3 February 2017, President Trump signed an executive order asking key regulators to prepare a report of existing laws and regulations that promote or inhibit the ‘Core Principles’ of the Trump administration’s vision for the US financial system, those core principles being:

- promoting and empowering financial independence and informed choices in the financial marketplace;
- preventing taxpayer-funded bailouts;
- engaging in a more scrupulous evaluation of financial regulations that address systemic risk and market failures in an effort to promote economic growth and stronger financial markets;
- enabling American companies to be competitive with foreign firms both in the US market and abroad;
- advancing American interests in international financial regulatory negotiations and meetings; and
- restoring public accountability within financial regulatory agencies and rationalising the financial regulatory framework.

What is the Dodd-Frank Wall Street Reform and Consumer Protection Act and what are its major provisions?
Dodd-Frank is a major piece of US financial services legislation passed by Congress in 2010 to respond to many of the key issues arising from the global financial crisis (GFC) of 2008–09. It was initially targeted at reducing the size of banks that are too-big-to-fail and thereby require governmental support when they face insolvency. But, as enacted, Dodd-Frank is much more wide ranging and covers too many areas to summarise in a short interview. However, by way of example, among the major changes it introduced were:

- the creation of several new federal financial regulatory agencies, committees, councils, bureaus, and offices, while simultaneously merging and eliminating others;
- the creation of an orderly liquidation authority for systemically important financial institutions (SIFIs);
- the so-called ‘Volcker Rule’ prohibiting, with certain exceptions, proprietary trading by bank entities and ownership or sponsorship of hedge or private equity funds; and
- substantial regulation of swap dealers and the over-the-counter derivatives market.

Dodd-Frank also introduced a new regulatory body, the Consumer Financial Protection Bureau, tasked with enforcing existing consumer financial protection laws.
What would the potential repeal or substantial amendment of Dodd-Frank mean for the EU, the UK and the global regulatory structure? Given the international nature of the financial markets, would it sit easy with current EU reforms such as EMIR and AIFMD and equivalent laws in most jurisdictions where there are major financial markets?

It appears unlikely that President Trump would seek to repeal Dodd-Frank in full. Instead, amendments are likely to be targeted. In particular there is currently no reason to believe that the creation of the orderly resolution authority would be affected (save possibly (i) orderly liquidation for non-bank SIFIs under the Bankruptcy Code (see below), and (ii) an exclusion from the requirement to prepare ‘living wills’ or resolution plans for smaller institutions with the current threshold beginning at US$50 billion in total assets (that is US assets for foreign banks)) or the work in relation to regulation of swap dealers and the derivatives markets. These are parts of Dodd-Frank which are particularly relevant to global financial markets.

A main focus is likely to be the operation of the Volcker Rule. Changes to this could permit US banks to have more freedom to trade securities. This could potentially give them a competitive edge over banks in Europe. However, US banks would argue that so-called universal banks in Europe can already trade securities in addition to undertaking banking business and that amending the Volcker Rule should not be seen as a negative thing because other aspects of banking and securities supervision will ensure that they manage their capital and liquidity responsibly and take fewer risks than were taken at the time of the GFC. EU legislation intended to do something similar to the Volcker Rule is currently going through the EU legislative process, but it is not clear if it will become EU law.

Would this increase risks and uncertainties for UK financial services firms, who are already looking at the problems potentially resulting from Brexit?

Possibly – much will depend on the extent to which those firms are doing business in the US and, in particular, whether they have legal entities that are regulated in the US. If they are mainly doing business in Europe or Asia it will not have much direct impact and if they are simply buying US investments through US securities firms then it will only affect the firms they use, and not them. For those who have a significant US business it could have a meaningful impact.

Is Dodd-Frank more likely to be amended than repealed, and what support is there for this in the US Congress? Are the proposals of the Chairman of the House of Representatives Financial Services Committee, Jeb Hensarling, likely to be influential (and if so, what are they)?

Dodd-Frank is more likely to be amended, and current Republican congressional proposals to do so will likely be a starting point for those discussions. Representative Hensarling’s proposed Financial CHOICE Act would provide for an alternative to certain Dodd-Frank concentration and other limits imposed on acquisitions for banks that satisfy an enhanced leverage ratio (presumably with the hope of increasing bank M&A activity). It would also:

■ exclude non-banks from SIFI designation and manage their orderly liquidation through the Bankruptcy Code rather than the FDIC’s resolution authority; and

■ repeal the Volcker Rule.

Are there any other interesting trends or developments stemming from President Trump’s proposals affecting financial markets that are worth mentioning?

Republican (not necessarily Trump) proposals would require more transparency for Federal Reserve monetary policy decisions and may curtail the Community Reinvestment Act which, in part, requires banks to make loans to low- and moderate-income borrowers, a mandate that some argue contributed to the mortgage crisis and other contributors to the GFC. We have also seen President Trump’s directive for ‘no new regulations’ call into question the future of some Dodd-Frank rules that have not yet been finalised, including rules related to incentive compensation, single counterparty credit limits and enhanced standards for SIFIs.

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In brief …
This bulletin briefly introduces our more detailed handbook on interval funds. The purpose of the handbook is to:

■ place interval funds squarely in their US regulatory framework;

■ discuss how they operate from a mechanical standpoint; and

■ cover the various investment approaches that they can incorporate, including a discussion of SEC staff positions on how interval funds may invest in private funds available to accredited investors.

What are interval funds?
As yet another demonstration of the investment management industry’s ability to develop products to meet the demands of investors and their advisers, we have the ‘interval fund’. These funds are SEC-registered closed-end funds that in most cases engage in continuous offerings of their securities. They typically price and sell their shares daily, but do not list them on an exchange; they redeem shares by making periodic tenders in compliance with Rule 23c-3(b) of the Investment Company Act of 1940 (the 1940 Act).

Why does this matter?
What can interval funds do that other pooled investment vehicles in the marketplace cannot do (or must do differently)? The answer is that interval funds can give shareholders and their financial professionals many of the transparency, valuation and investor protection elements of the 1940 Act. They permit investments in underlying assets that are (or may be) illiquid, yet offer investor liquidity on a periodic basis. This means that an interval fund can be a suitable vehicle in which to run ‘alternative’ strategies — ie strategies that utilize illiquid assets and that are designed to produce returns that are not highly correlated to the broader stock and bond markets. Interval funds also mesh well with certain noteworthy regulatory initiatives, making them attractive vehicles for use by independent broker-dealers and other financial advisors that must operate within the complex regulatory environment.

If you would like further details, please read our full DLA Piper handbook called Interval Funds — at the Intersection of Liquidity, Transparency, and Valuation¹.

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In brief...
The UAE has issued the new Federal Law No. 20 of 2016 on Mortgaging Moveable Properties as Surety for Debts (New Mortgage Law), which was published in the latest issue of the Federal Official Gazette (number 609) on 15 December 2016 and is intended to come into effect 90 days from the date of publication.

The New Mortgage Law is a welcome development for both lenders and borrowers looking to enter into secured lending arrangements in the UAE and addresses some of the more cumbersome aspects of taking security. In addition, the law helpfully provides a legislative basis for taking security over a wide variety of moveable property, removing some of the uncertainties to date in relation to how the creation and enforcement of security operate in the UAE.

What has changed under the New Mortgage Law?
Taking security over moveable property in the UAE has predominately been governed by the UAE Civil Code No. 5 of 1985 (Civil Code) and the Federal Commercial Transactions Law No. 18 of 1993 (Commercial Code). These laws adopted the most traditional method of creating effective security over moveable property by requiring possession of the moveable property to be delivered to the secured creditor. While this approach was developed to ensure that the world is put on notice that a pledge over the secured property has been created, it is often not particularly practical and prevents a debtor from being able to utilise fully all of its assets for the purposes of security. Although the Commercial Code does provide for a statutory mortgage over commercial businesses without the requirement to deliver possession, this form of security can be cumbersome in practice given the notarisation and registration requirements and the practical limitation that only a bank licensed in the UAE can take this sort of security.

By contrast, the New Mortgage Law introduces the possibility of creating security without the need to deliver possession of the secured asset. Instead, security may be created by the parties entering into a written agreement which complies with the requirements of executive regulations which are to be introduced (Executive Regulations). The security interest will be effective against third parties upon registration on an electronic register (to be established).

There is currently no requirement under the New Mortgage Law for a secured creditor to be a licensed UAE bank (as compared for example to Dubai Law No. (14) of 2008 concerning mortgages in the Emirate of Dubai). It will be interesting to see whether this restriction appears in the Executive Regulations or indeed is required as a matter of practice in order to register a security interest. It would obviously be helpful for international lenders who are lending on a multi-jurisdictional transaction (and looking to collateral from a UAE security provider) if there is no such restriction.

The New Mortgage Law provides that any moveable assets (including future assets and intangible assets) may be secured in the above manner, expressly including:

- receivables;
- accounts and bank deposits;
- bonds and title deeds transferable by way of delivery or endorsement;
- equipment and work tools;
- tangible and intangible constituents of the commercial premises;
- goods ready for sale or lease and raw materials and commodities;
- movable property which is affixed to real property but capable of division; and
- other moveable property provided that applicable laws permit these assets to be secured.

In common with other security laws which have been developed recently (such as the Australian Personal Property Security Law), certain moveable property is excluded such as personal goods (other than by way of consumer finance) and salaries.

The express reference to future property as property which may be secured is particularly significant and will particularly assist lenders and borrowers looking to secure future payment streams. In addition, the previous uncertainty in relation to taking security over bank accounts with fluctuating balances is also clarified and should provide comfort to lenders seeking to take this type of security and should remove the need for lenders and borrowers to enter into periodic supplemental security agreements in an effort to overcome these limitations.

In addition, the New Mortgage Law clarifies that a secured creditor who has registered its interest will have a secured right in the proceeds over a secured asset. This is particularly
important in relation to a business which is relying upon the
disposal of secured assets in order to generate the revenue
to repay the secured indebtedness. The New Mortgage Law
requires registration of this new security interest “unless the
Parties otherwise agree” which would suggest that the Parties
can contract out of this provision.

On the face of the New Mortgage Law, it falls short of
introducing a security interest equivalent to the English law
concept of a floating charge, but it should enable security
to be taken over a much wider class of movable property.

Perfection of security interest
In addition to the registration requirements mentioned
above, it will also be necessary to notify any possessor
of the secured property of the security if the relevant
property is not in the possession of the security provider.

Priority of security interests
Article 17 of the New Mortgage Law states that registration
of a pledge will protect the secured party by giving the
pledgee priority over other creditors. According to this
Article, priority shall be determined in accordance with
the date of registration of the relevant pledge (unless the
pledgee waives its priority in writing and registers such
waiver in the register in accordance with Article 24).

It should be noted that priority of security interests that
pre-date the New Mortgage Law (which are registered in
accordance with Article 44 of the New Mortgage Law) will
be determined in accordance with the date of creation of
that security interest.

It is not clear who will be able to access the register and
this is to be clarified in the Executive Regulations. Given the
certainty that a register is able to provide in establishing
whether or not an asset is secured, it will be helpful if the
Executive Regulations provide for third parties to be able
to freely access the register.

Enforcement
The New Mortgage Law also introduces the concept of
self-help remedies in relation to certain types of security
(for example, set-off of secured bank accounts is expressly
permitted). While enforcement of security would
previously require a court order that would be both in the
court’s discretion and would require the underlying debt
to be proven, Articles 28 to 33 of the New Mortgage Law
provide additional mechanisms that allow the secured party
to enforce its security interest without requiring a public
auction through the courts, although the court has the
power to set a minimum limit to the sale price or decide
on the method of sale. This has the potential to provide
creditors with an efficient and cost effective method of
enforcement and it will be interesting to see how the
practice develops.

Next steps
The New Mortgage Law will come into force 90 days after
its date of publication and the law contemplates that the
Executive Regulations will be promulgated within six months
of the law coming into effect. It is not clear when the register
will be effective although it is hoped that is will be in operation
when the Executive Regulations are announced.

Like all new developments, the New Mortgage Law poses
quite a few questions as to how it will operate in practice.
While the Executive Regulations will be crucial for the
purposes of ascertaining what form the security instrument
should take and the method for registration (including
any associated fees) and the ability to search the register;
there are other aspects of the New Mortgage Law which
will need to be considered and, no doubt, the market will
develop in the next few years in this respect. However,
the New Mortgage Law is an important and encouraging
step in the development of a regime which should prove
much more efficient for borrowers and lenders alike.

From a borrower’s point of view, we would expect it
to promote investment and the availability of credit by
enabling a larger pool of assets to be used to collateralise
such credit together with a more cost-effective process
for the creation and perfection of security interests. From
a lender’s point of view, the New Mortgage Law provides
some much needed comfort in relation to which assets
may be secured, the process for doing so and a clearer set
of priority rules between creditors.

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