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FOREIGN EXCHANGE COMMITTEE MASTER AGREEMENTS AS INTERNATIONAL CONTRACTUAL STANDARDS FOR FOREIGN EXCHANGE DERIVATIVES

INTRODUCTION. *The ISDA Master Agreement is possibly the most authoritative cross-border contractual standard in the world of financial markets. It also serves as an example for the local transactional documentation drafters in various countries to regulate the conclusion and performance of over-the-counter derivatives transactions by means of bilateral contracts. However, international master agreements for derivatives and other financial products are not limited to the templates produced by International Swaps and Derivatives Association (ISDA). Foreign Exchange Committee (FXC) suggests a remarkable alternative to the documents maintained by this powerful industry club as far as transactions with foreign currency are concerned.*

MATERIALS AND METHODS. *International Foreign Exchange and Currency Option Master Agreement (IFXCO) and other FXC master agreements served as primary sources of the present article. Its methodological base is represented by general scientific methods (analysis, synthesis, induction, deduction) as well as specific legal research methods. In particular, formal legal method was employed for the literal interpretation of the provisions of FXC standard documentation, historical method was invoked to describe the evolution of standard FXC templates,*

while comparative legal method was used to undertake a comparative analysis of insolvency laws where appropriate.

RESEARCH RESULTS. *The article gives a general overview of master agreements in financial markets to put FXC documentation into a broader context of standard contracts publication in financial markets. The analysis of FXC master agreements is carried out through conclusion and performance of FX transactions as well as risk mitigation mechanisms analysis such as close-out netting and collateral. Moreover, the article covers governing law and enforceability issues as well as puts FXC documentation into Russian legal context. Although Russian court, with a high degree of probability, will recognize the choice of governing law made by the parties to the relevant master agreement published by FXC, the enforceability of collateral and close-out netting provisions amidst the bankruptcy of a Russian entity is not secured due to non-recognition of FXC documentation by the Russian authorities.*

DISCUSSION AND CONCLUSIONS. *Author comes to conclusion that despite FXC master agreements are not able to compete with ISDA documentation. However, they are popular with certain financial institutions active in foreign exchange markets. To facilitate the development of Russian financial market*

the the list of recognized master agreements should be broadened by addition of documentation produced by FXC. Arguably, it is necessary to amend these provisions and make them compliant with UNIDROIT as well for the purposes of transactions with banks from the countries considered “friendly” to Russia.

KEYWORDS: derivatives, foreign exchange transactions, international contracts, Foreign Exchange Committee, ISDA, netting, master agreement, financial collateral, *lex mercatoria*

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ГЕНЕРАЛЬНЫЕ СОГЛАШЕНИЯ ВАЛЮТНОГО КОМИТЕТА КАК МЕЖДУНАРОДНЫЕ ДОГОВОРНЫЕ СТАНДАРТЫ ДЛЯ ВАЛЮТНЫХ ДЕРИВАТИВОВ

ВВЕДЕНИЕ. Генеральное соглашение Международной ассоциации по свопам и деривативам (МАСД) возможно является наиболее авторитетным трансграничным договорным стандартом в мире финансов. Оно также служит примером для авторов стандартной документации локального масштаба, составляемой с целью правового регулирования порядка заключения и исполнения внебиржевых деривативных сделок при помощи двухсторонних договоров. Однако, международные стандартные договоры не ограничиваются соглашениями МАСД. Валютный

комитет (ВК) предлагает альтернативу документации этой влиятельной профессиональной ассоциации для заключения сделок с иностранной валютой, которая представляется достойной внимания.

МАТЕРИАЛЫ И МЕТОДЫ. Международное рамочное соглашение для валютных сделок и опционов (МРСВСО) и другие рамочные договоры послужили основным материалом для настоящей публикации. Ее методологическая основа представлена общенаучными методами (анализ, синтез, индукция, дедуция), а также специальными

юридическими методами. В частности, формальный юридический метод применялся для буквального толкования положений документации ВК, исторический метод использовался для описания процесса развития соглашений ВК, а сравнительно-правовой метод был применен для сопоставительного анализа законодательства разных стран, где это было целесообразно.

РЕЗУЛЬТАТЫ ИССЛЕДОВАНИЯ. В статье приведен обобщенный анализ рамочных договоров на финансовых рынках с целью рассмотрения рамочных соглашений ВК в более широком контексте стандартной документации на финансовых рынках. Анализ рамочных договоров ВК проведен путем рассмотрения порядка заключения и исполнения валютных сделок, а также договорных механизмов снижения риска, таких как ликвидационный неттинг и применение финансового обеспечения. Также статья затрагивает вопросы применимого права и принудительного исполнения договорных положений в контексте российского правового регулирования. Хотя российский суд признает выбор права сторонами соответствующего рамочного соглашения ВК, обращение взыскания на обеспечение и ликвидационный неттинг в ходе несостоятельности российских юридических лиц не гарантированы в силу отсутствия признания соглашений ВК российскими властями.

ОБСУЖДЕНИЕ И ВЫВОДЫ. Автор приходит к выводу о том, что рамочные договоры ВК не в

состоянии составить конкуренцию документации МАСД. Однако, они востребованы среди определенных финансовых институтов, активных на валютном рынке. Кроме того, в отличие от МАСД ВК не ограничил доступ к своей документации для российских сторон и не исключил российские лица из перечня своих членов. Для развития отечественного валютного рынка представляется целесообразным расширить перечень признаваемых рамочных соглашений путем включения в него соглашений ВК. Такое расширение не только позволит в большей степени соответствовать требованиям УНИДРУА, но и соответствует целям заключения сделок с банками из «дружественных» России юрисдикций.

КЛЮЧЕВЫЕ СЛОВА: деривативы, валютные сделки, международные контракты, Валютный комитет, ISDA, неттинг, рамочный договор, финансовое обеспечение, *lex mercatoria*

ДЛЯ ЦИТИРОВАНИЯ: Клементьев А.П. 2023. Генеральные соглашения Валютного комитета как международные договорные стандарты для валютных деривативов. – *Московский журнал международного права*. № 2. С. 38–50. DOI:<https://doi.org/10.24833/0869-0049-2023-2-38-50>

Автор заявляет об отсутствии конфликта интересов.

1. Introduction

Back in 1846, Joseph Story, an associate justice of the Supreme Court of the United States and the author of the famous treatise on the conflict of laws, called foreign contracts a highly important branch of international jurisprudence [Story 1846:201]. Bertold Goldman, one of the fathers of the new *lex mercatoria* [Goldman 2009], placed an emphasis on standard contracts of the International Corn Trade Association as a source of the modern law merchant. The primary characteristics of standard contracts are their written form and the avail-

ability to the parties before the commencement of the negotiation process [Schmithoff 1968:551]. In the modern world, such standard contracts are extremely important in the contemporary derivatives industry [Braithwaite 2012:780] due to their reliability, time saving opportunities and recognition by the regulators of financial markets [Wood 1995:217].

According to the simplest definition, derivatives are financial contracts with a value deriving from some other asset such as foreign currency, securities, or interest rates¹. An asset, financial indicator, commodity or other variable giving rise to the value of a derivative financial instrument is called an underly-

¹ Global Derivatives Study Group: Derivatives: Practices and Principles. 1993. P. 28. URL: https://group30.org/images/uploads/publications/G30_Derivatives-PracticesandPrinciples.pdf (accessed 19.03.2023).

ing asset [Brealey, Mayers 2003:758] or simply an underlying. On-exchange derivative transactions such as futures, the oldest type of derivative financial instruments [Brealey, Mayers 2003:758], are governed by exchange and clearing rules having contractual rather than statutory nature and adopted by relevant exchanges and clearing institutions in line with legislative requirements. In contrast to the on-exchange derivatives trading, over-the-counter derivatives market requires standard contracts to set out mutual rights and responsibilities of its participants. In other words, financial institutions and corporations use standard forms as templates for the documents they need [DeRosa 2014:215]. Those forms are drafted, maintained, and updated by professional associations that connect derivative traders with end-users.

The financial sector of the global economy is proud of its master agreements as they withstood the financial crisis enormously impacting the global economy in 2006-2008 [Paech 2016:855]. This article considers standard contractual templates of the Foreign Exchange Committee (FXC), an industry club established in 1978 in New York and since then being responsible for the publication of master agreements setting out a legal framework for foreign currency transactions such as options and forwards. Although global derivatives market to a great extent functions on the basis of standard master agreements of the International Swaps and Derivatives Association (ISDA) [Muscat 2009:33] such as 1992 ISDA Master Agreement and 2002 ISDA Master Agreement enjoying a celebrity status [Braithwaite 2012:784], this article claims that there is a place for FXC contracts in documenting derivatives transactions as well.

Numerous soft law instruments support the use of standard contracts in derivatives trade through promoting their enforceability in an insolvency scenario. As the violation of obligations by one of the parties to a master agreement or the occurrence of certain termination events such as illegality or force majeure results in netting of obligations (i.e. extended contractual set-off), master agreements produced

by professional associations are often called “netting agreements”. UNCITRAL paid some attention to these instruments in its UNCITRAL Legislative Guide on Insolvency Law² while UNIDROIT embedded provisions on termination of obligations under netting agreements into the Convention on Substantive Rules for Intermediated Securities³. The pivotal role in the process of developing favorable legislative environment for the agreements in question was played by ISDA and its model laws on netting⁴.

2. FXC Master Agreements: the General Characteristics

The scope of ISDA agreements (e.g., commercial transactions that may be governed by this contractual template) is astonishingly broad and includes repurchase transactions, buy-sell back transactions and many others [Bryceson 2010]. That variety has drawbacks of its own – although governed by the laws of the most significant financial centers in the world⁵ – ISDA contractual standards are quite lengthy and too detailed. Instead of producing one single contract covering all types of derivatives and even going beyond those transactions, FXC concentrated its efforts on financial products having an underlying asset in the form of foreign currency, so-called FX transactions. Foreign currency products have a major importance for international finance and trade since FX transactions allow financial institutions to buy necessary amounts of foreign currency and give access to hedging. In economic terms hedging involves taking on one risk to offset another one, for instance through buying or selling a futures contract [Brealey, Mayers 2003:758].

Although the rights to FXC standard documentation are reserved with FXC, the drafter of its contractual templates is the Financial Markets Lawyers Group (FMLG)⁶, an association of lawyers supporting over-the-counter foreign exchange contracts alongside other transactions in financial markets. According to FMLG website, the group has origi-

² UNCITRAL: Legislative Guide on Insolvency Law. URL: https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/05-80722_ebook.pdf (accessed 19.03.2023).

³ The UNIDROIT Convention on Substantive Rules for Intermediated Securities (Geneva Securities Convention). URL: <https://www.unidroit.org/instruments/capital-markets/geneva-convention/> (accessed 19.03.2023).

⁴ Most recent ISDA Model Netting Act was published in 2018. URL: <https://www.isda.org/2018/10/15/2018-model-netting-act-and-guide> (accessed 19.03.2023). It replaced previous soft law instruments unveiled by ISDA in 1996, 2002 and 2006.

⁵ ISDA documentation is governed by English and New York state law. Recently ISDA partly switched to French and Irish law in response to Brexit by publishing a new version of 2002 ISDA Master Agreement. URL: <https://www.isda.org/2018/07/03/isda-publishes-french-and-irish-law-master-agreements/> (accessed 19.03.2023).

⁶ The Financial Markets Lawyers Group. URL: <https://www.newyorkfed.org/fmlg/index.html> (accessed 19.03.2023).

nated in the 80s and is currently sponsored by the Federal Reserve Bank of New York. The members of the group include representatives of a variety of major financial institutions such as Bank of America, Barclays, Morgan Stanley, and Citigroup⁷. The representatives of the Federal Reserve Bank of New York serve in FXC *ex officio* and compose approximately one third of the committee. The ongoing work of FXC includes activities in the field of FX trading and management, mitigation of risks as well as taking care of public policy issues. Moreover, FXC regularly monitors the volume of foreign exchange operations and publishes relevant statistics thus producing a clear picture of FX markets.

In contrast to ISDA FXC never produced a soft law instrument promoting enforceability of its standard contracts, although it is obviously capable of exerting influence on global financial sector. However, thanks to FMLG lawyers' assistance, FXC is able to raise its voice when it comes to the most notable court cases involving foreign exchange markets through the publication of amicus briefs⁸. For instance, in case of *Jugobanka A.D. v. Superintendent of Banks* FXC joined efforts with ISDA to submit a brief in support of the appellant to the United States Court of Appeals for the Second Circuit with a view to secure the multi-branch netting efficiency⁹. Back in the 90s FXC supported William C. Dunn & Delta Consultants, Inc. in its litigation against the Commodity Futures Trading Commission (CFTC), a powerful regulator of US derivatives industry¹⁰.

FMLG and FXC contractual work resulted in the publication of a "series of master agreements" [DeRosa 2014:215]. ICOM (International Currency Options Market Master Agreement)¹¹ created a framework for options while IFEMA (International Foreign Exchange Master Agreement) governed all foreign exchange agreements other than options¹². FEOMA (Foreign Exchange and Options Master Agreement)¹³ represents a generic contract for both options and forwards involving foreign currency. Apart from that, FXC made some standardization efforts in the precious metals sector. The subject of 1994 International Bullion Master Agreement¹⁴ is a so-called bullion transaction – a trade involving gold, silver or other precious metals in the form of bullions.

As ICOM, IFEMA and FEOMA were published in the middle of the 90s, in 2003 FXC launched a study with a view of determining whether an update to its standard agreements is necessary. The study revealed that some notable developments took place in the market where FXC operates. In June 2005 FXC published a guide on the development of its standard documentation which, *inter alia*, revealed the reasons for the change¹⁵. Some of them, such as the failure of the Long Term Capital Management hedge fund and the 1998 Russian sovereign default, are related to economic trends in international financial markets. Others, such as the publication of 2002 ISDA Master Agreement and the 1998 FX and Currency Options Definitions Publication¹⁶ fall into purely legal

⁷ The Financial Markets Lawyers Group: Governance. URL: https://www.newyorkfed.org/fmlg/member/current_member.html (accessed 19.03.2023).

⁸ The Financial Markets Lawyers Group: Amici Briefs. URL: <https://www.newyorkfed.org/fmlg/legal/amici.html> (accessed 19.03.2023).

⁹ The Financial Markets Lawyers Group: Brief of amicus curiae International Swaps and Derivatives Association, inc. and the Foreign Exchange Committee in support of the brief for appellant. December 16, 2004. URL: [newyorkfed.org/medialibrary/microsites/fxc/files/news/2004/fxc041214.pdf](https://www.newyorkfed.org/medialibrary/microsites/fxc/files/news/2004/fxc041214.pdf) (accessed 19.03.2023).

¹⁰ The case reached the Supreme Court of the United States. See: The Financial Markets Lawyers Group: Brief of the Foreign Exchange Committee, the New York Clearing House Association, the Futures Industry Association, the Managed Futures Association and the Public Securities Association as amici curiae in support of the petitioners. July 12, 1996. <https://www.newyorkfed.org/medialibrary/microsites/fmlg/files/legal/CFTCDunn1996.PDF> (accessed 19.03.2023).

¹¹ The Financial Markets Lawyers Group: International Currency Options Market Master Agreement. 1997. URL: <https://www.newyorkfed.org/medialibrary/microsites/fmlg/files/icom.pdf> (accessed 19.03.2023).

¹² The Financial Markets Lawyers Group: International Foreign Exchange Master Agreement. 1997. URL: <https://www.newyorkfed.org/medialibrary/microsites/fmlg/files/ifema.pdf> (accessed 19.03.2023).

¹³ The Financial Markets Lawyers Group: International Foreign Exchange and Options Master Agreement. 1997. URL: <https://www.newyorkfed.org/medialibrary/microsites/fmlg/files/feoma.pdf> (accessed 19.03.2023).

¹⁴ The Financial Markets Lawyers Group: International Bullion Master Agreement. 1994. URL: https://www.newyorkfed.org/medialibrary/microsites/fmlg/files/fmlg_1994_bullion.PDF (accessed 19.03.2023).

¹⁵ The Financial Markets Lawyers Group: Guide to Changes to the FXC Master Agreements. URL: https://www.newyorkfed.org/medialibrary/microsites/fxc/files/ifxco_guide.pdf (accessed 19.03.2023).

¹⁶ The 1998 FX and Currency Options Definitions were jointly published by ISDA, FXC and Trade Association for the Emerging Markets URL: <https://www.isda.org/book/1998-fx-and-currency-option-definitions/> (accessed 19.03.2023). ISDA is very active in the field of standard definitions publication when it comes to regulating separate groups of derivatives depend-

domain. After consideration of those events, FXC finally decided to move to one single agreement for all types of foreign exchange transaction¹⁷. International Foreign Exchange and Currency Option Master Agreement (IFXCO) covers the variety of such transactions and is more in line with ISDA Master Agreement [DeRosa 2014:215].

In contrast to ISDA documentation¹⁸, there is no evidence that the influence of FXC agreements on local derivatives markets is enough to serve as an example for standard contracts drafters from country-wide associations and banking unions. An explanation to such unpopularity may be found in the fact that FXC itself prepares its standard contracts in cooperation with local banking associations, thus decreasing the need for others to copy its approaches to the preparation of standard documentation. Local associations that cooperated with FXC include Canadian Foreign Exchange Committee, British Banking Association, Tokyo Foreign Exchange Market Practices Committee [DeRosa 2014:215].

Furthermore, FXC contract drafting efforts got some attention from researchers and academics. D.F. DeRosa notes that FXC is the drafter of standard documentation in foreign exchange markets alongside ISDA [DeRosa 2014:215]. F.C. Nassetti considers ICOM and IFEMA alongside ISDA and ECHO, an agreement by the Exchange Clearing House Ltd, London establishing a multilateral foreign exchange netting system [Nassetti 1995:146]. As for the application of FXC contracts in practice, FXC in an IFXCO guide notes the use of its templates by hedge funds¹⁹. Information disclosed on the website of Securities Exchange Commission hints on the use of FXC templates by American financial institutions²⁰.

3. Conclusion and performance of FX transactions under FXC master agreements

Most FXC agreements are based on the “master agreement – schedule – confirmation” principle. This means that a party to a standard contract uses pre-printed form (the master agreement) in a manner very similar to the standard contractual terms of a bank or other financial institution asking their clients to adhere. The schedule represents an annex to the master agreement allowing the parties to set-out individual parameters of their interaction and introduce amendments to the master agreement to the extent they deem necessary. By individual parameters, one does not necessarily mean the payment details and the addresses of the parties, but also the threshold for cross-default and the meaning of financial indebtedness, a list of affiliated parties to spread the default triggers on and other contractual clauses providing the necessary degree of flexibility for the parties.

In the usual manner the parties execute both the master agreement itself as well as the schedule. However, in case of IFXCO FXC chose to change this approach as the latter consists of standard terms (IFXCO Terms) and an adherence agreement (IFXCO Adherence Agreement). Nevertheless, the way transactions involving foreign currencies are concluded, at least in the view of FXC, remained the same. Forwards, options and other types of transactions governed by FXC standard documentation can be entered into with a great degree of flexibility²¹. Although transactions may be concluded orally FXC agreements envisage subsequent delivery of confirmations²². Ph. Wood calls a confirmation a memorandum evidencing the terms of a transaction

ing on the underlying asset. See, e.g. ISDA Equity Derivatives Definitions. URL: <https://www.isda.org/book/2011-isda-equity-derivatives-definitions-and-appendix/> (accessed 19.03.2023); ISDA Credit Derivatives Definitions. URL: <https://www.isda.org/2014/06/30/2014-isda-credit-derivatives-definitions/> (accessed 19.03.2023).

¹⁷ Apart from that, the guide to the IFXCO mentions that an adoption of new ISDA Master Agreement in 2002 also required a response from FXC.

¹⁸ Apart from Russian standard documentation ISDA Master Agreement served as a source of contractual clauses for NAFMII [Ong, Hsiao 2013].

¹⁹ The Financial Markets Lawyers Group: Guide to Changes to the FXC Master Agreements. URL: https://www.newyorkfed.org/medialibrary/microsites/fxc/files/ifxco_guide.pdf (accessed 19.03.2023).

²⁰ The 2007 Foreign Exchange and Options Master Agreement. URL: <https://www.sec.gov/Archives/edgar/data/1504886/000119312511047651/dex104.htm> (accessed 19.03.2023).

²¹ See e.g. the definition of FX Transaction in section 1 of IFEMA stating that the parties may agree the terms of a transaction orally, electronically or in writing.

²² For instance, under section 2.3 of the ICOM option transactions shall be promptly confirmed by mail, telex, facsimile other electronic means capable of being reproduced in a hard copy. Same provisions are present in IFEMA, IFEOMA and other FXC agreements.

[Wood 1995:207] while J. Braithwaite maintains that trading in financial instruments takes place via telephone with subsequent delivery of confirmations [Braithwaite 2012:787]. That said, the use of confirmations in over-the-counter financial markets is a wide-spread usage.

The law sometimes requires contracts to be made in a specific form thus imposing formalities on the parties to a contract [Chen-Wishart 2011:140]. In England such formalities perform three main functions which include cautionary, evidentiary, and protective functions [Chen-Wishart 2011:141]. However, English contract law, a basic source of the law of contracts in Anglo-Saxon world, treats the requirement of form in a very liberal manner, and an informal exchange of promises is sufficient to form a contract²³. For that reason, the non-delivery of confirmations does not result in the invalidation of transactions concluded under an FXC agreement. This is relevant for transactions concluded orally; however, the parties grant each other a consent to the recoding of phone conversations so that necessary evidence may be provided in case of a dispute²⁴.

Apart from transaction conclusion another important aspect is transaction performance, i.e., the way a party to the contract should act to discharge its contractual obligations. Performance shall take place in accordance with mutually agreed terms through the delivery of the relevant currency to the account specified in an FXC agreement²⁵. Deliverable forwards and options envisage the transfer of funds by both counterparties. In case a derivative is cash-settled, meaning that the exact amount to be received by a party depends on the formula embedded in the documentation, a delivery of the so-called “in-the-money” amount is made by one party only. P.R. Wood calls such contracts “transactions for differences” and mentions that most derivatives are performed this way [Wood 1995:207].

However, should a transaction envisage payments in the same currency and on the same date, a netting mechanism comes into play. Netting is an instrument leading to the offset with respect to payments in the opposite direction and effectively allowing to reduce settlements and minimize risks arising out of transactions in the financial markets. Derivatives markets rely several types of netting [Benjamin 2010:800]. Two types of netting are used during the regular interaction of the parties – payment netting and netting by novation. While the former provides for the discharge of payment obligations of the parties having the same currency and the same payment date exclusively on the majority date, netting by novation gives rise to discharge each time a new transaction is concluded.

Apart from easing the settlements between the parties to financial transactions (including those envisaging the delivery of foreign currency which is relevant for FXC), netting is an effective method for achieving the degree of risk mitigation giving the necessary comfort to the participants of financial markets and their regulators. Payment netting works as a means of decreasing settlement risk which arises during the settlement day in case a party does not fulfill its obligations. The parties to standard agreements use the instrument called netting. FXC agreements encompass both types of “regular” netting²⁶. However, in case of emergency a different type of netting is used – close-out netting allows a non-defaulting party to terminate transactions and calculate a net amount with a view to reduce the risk of severe loss suffered to the insolvency of a defaulting counterparty²⁷.

Apart from settlement and netting clauses, FXC agreements contain typical contractual clauses that one would expect to see in a commercial agreement. For instance, severability clause provides for a validity of contractual provisions in case some other provision within FXC agreement is considered invalid²⁸.

²³ However, several exceptions implemented by statute still exists. Such exceptions are (i) a lease for more than 3 years, (ii) most contracts for the disposition of interest in land whether by sale or otherwise, and (iii) contracts of guarantee. See: Allen & Overy International Law Firm: Basic principles of English contract law URL: <http://www.a4id.org/wp-content/uploads/2016/10/A4ID-english-contract-law-at-a-glance.pdf> (accessed 19.03.2023).

²⁴ See e.g., section 8.3. of IFEMA B. Muscat notes that a trade is usually agreed by a telephone call which is considered to bind the entities of the dealers of the relevant counterparties [Muscat 2009: 44].

²⁵ See e.g., Section 3.1. of IFEMA.

²⁶ See e.g., Sections 3.2 and 3.3 of IFEMA.

²⁷ See e.g. sections 5.1-5.8 of IFEMA More detailed explanations on the risk mitigation potential of close-out netting are available in a working paper jointly published by the representatives of the Federal Reserve Bank of Chicago and Loyola University Chicago URL: https://www.chicagofed.org/digital_assets/publications/working_papers/2004/wp2004_02.pdf (accessed 19.03.2023).

²⁸ Section 8.6 of IFEMA.

In an analogous manner FXC included provisions on absence of waivers, waiver of immunity, the way notices are to be delivered, provisions on assignment, and currency indemnity. Standard commercial representations and warranties are also present in FXC agreements. Such representations and warranties include existence of authority to conclude the framework contract itself and transactions thereunder, authorization of the representatives of the parties, the binding character of the agreement, absence of events of default and acting as a principal rather than an agent²⁹. The schedules to FXC agreement also provide for the opportunity to give so-called regulatory representations.

Currency indemnity provision³⁰ is of major importance in the current scenario of mutual economic sanctions adopted by the United States of America, United Kingdom, the European Union, Switzerland and others on one hand, and Russian Federation on the other. Due to the limitations on currency transfers a party to a transaction under an FXC agreement may have a strong incentive to perform its contractual obligations in a currency not stipulated in the relevant confirmation. For example, in case a currency pair for a foreign currency forward transaction is United States dollar vs Russian ruble, a Russian counterparty may be restricted in its ability to successfully deliver rubles to a foreign bank account opened in favor of its foreign counterparty. In that case it would be more comfortable to perform such a transaction in rubles, especially when a foreign counterparty already has, for whatever reason, a ruble account opened within a Russian credit institution, and a Russian counterparty has the details of such account. Moreover, under Russian presidential decree a legal entity established in the Russian jurisdiction may fall under a statutory obligation to pay in rubles³¹.

4. Close-out netting and collateral

According to FXC charter³², the objectives of this organization are numerous and include, among other things, the support of integrity, efficiency, and

resiliency of the global foreign exchange market and providing guidance and leadership to this market. Achieving those ambitious objectives is hardly possible without due consideration of risks existing in financial market that its participants face every day. While credit risk is insolvency related [Nasseti 1995:145] and comes solely from the counterparty and its ability to honor its monetary obligations, systematic risk relates to general failure of financial system. The latter is impossible to avoid by carefully evaluating the credit quality of a counterparty to an option or forward no matter how thoroughly a risk manager scrutinizes the financial reports of a company or financial institutions. Other risks present in financial markets include liquidity risk, sovereign risk, delivery risk and market risk [Nasseti 1995:145].

Being one of the reasons for updating FXC agreements and the publication IFXCO, the insolvency of Long Term Capital Management (LTCM) is an example of credit risk event which could have potentially triggered the systematic risk. This prominent hedge fund generated high returns and served as a supplier of liquidity to multiple participants of international financial markets, but eventually collapsed in 1998, several years since it was set up [Brealey, Mayers 2003:1003]. Its insolvency was in a way related to the 1998 financial crisis as in the wake of the crisis investors started selling illiquid assets severely affecting LTCM as its strategy was built over holding large volume of illiquid assets and hedging them through liquid ones. Finally, the Federal Reserve Bank of New York, the sponsor of FXC, had to encourage a group of financial investors to bail out LTCM to avoid systematic risk event [Brealey, Mayers 2003:1003].

Minimizing counterparty risk and avoiding systematic risk would be impossible without promoting close-out netting, a vital risk mitigation tool invoked by one a non-defaulting party amidst insolvency or upon an occurrence of an event of default with respect to its counterparty. It is usually present in a standard-form master agreement [Böger 2013:237]. Due to the presence of this type of netting such contracts are often referred to as “netting agreements”. Close-out netting is the cornerstone of FXC agree-

²⁹ Section 4.1 of IFEMA.

³⁰ Section 8.1 of IFEMA.

³¹ Decree of the President of the Russian Federation dated March 5, 2022 No. 95 “On the temporary procedure for the fulfillment of obligations to certain foreign creditors”. (In Russ.). URL: <http://publication.pravo.gov.ru/Document/View/0001202203050062?ysclid=1542uv4fub983092542> (accessed 19.03.2023).

³² The Financial Markets Lawyers Group: Foreign Exchange Committee Charter. Effective Date: April 17, 2019 URL: newyorkfed.org/medialibrary/microsites/fxc/files/FXC_Charter_2019.pdf (accessed 19.03.2023).

ments since it provides a valuable risk mitigation tool available to the parties of financial transactions as it puts the relevant creditors into the more privileged position compared to other creditors [Jonson 2015:102]. Close-out netting provisions in international master agreements in financial markets are drafted based on two contractual models – set-off and conditional novation. While conditional novation requires those transactions to be terminated and replaced by the net amount representing the balance of their market values the set-off model suggests that the obligations under transactions become due and payable irrespective of their term and subsequent offsetting of those amounts. ISDA Master Agreement sets out an example of conditional novation contractual language. Set-off model is embedded into standard contracts in repo, securities lending and interbank deposit markets³³.

The process itself is quite complex since it involves multiple stages. Some say that the exact number of those stages is three [Benjamin 2007:268] while others maintain that four stages are present when it comes to closing out derivative transactions [Paech 2016:864]. As ISDA contractual documentation, FXC master agreements dwell upon the conditional novation approach³⁴. The most obvious ground to trigger close-out netting is an insolvency of a counterparty. FXC agreements contain a very broad list of insolvency related events such as his trigger of close-out netting is formed in various forms³⁵. Close-out netting may commence in an automatic manner as in some countries this is required to match insolvency law requirements³⁶.

Other events of default include cross-default, failure to pay, breach of representation, credit support default, default under specified transaction and some

others. As default is the result of an undesirable behavior of a counterparty [Braithwaite 2012:787], all those events are related to the violation of the obligations by the party vis-à-vis its counterparty under an FXC agreement (failure to pay, default under specified transaction), a provider of personal security under a guarantee or suretyship (credit support default) or other counterparties (in such circumstances it is not surprising that a solvent party would like to close-out its transactions. Apart from that the parties to FXC agreement may establish an event of default of their own and indicate it in the schedule (for agreements other than IFXCO) or the adherence agreement to IFXCO. The early termination date is designated unless the parties agree to automatic termination of transactions. Until such date occurs, the terminating party is required to calculate the resulting gains and losses due to the early termination of foreign currency transactions.

Collateral is widely used in financial markets, moreover, some financial transactions involve collateral from the outset – this is relevant for repurchase agreements and securities lending arrangements. Repurchase agreements are entered into between a party having securities and wishing to obtain financing and another party ready to provide funds and take collateral as a title transfer security. In essence, repurchase transactions have the same economic profile as a loan agreement secured by a pledge of equities or bonds, although the legal form of those arrangements is different. The same is relevant for securities lending contracts where a party interested in obtaining securities for a period takes them from another party. Contractually, these trades are put in paper in over-the-counter markets using GMRA and GMSLA agreements.

³³ The master agreements based on that approach are widely spread – apart from GMRA and GMSLA an English law governed standard agreement for interbank deposits also allows financial institutions to close out their transaction through acceleration of mutual obligations rather than their early termination See: The 1996 International Deposit Netting Agreement URL: <http://www.efmlg.org/Docs/Meeting%2013/Item%205%20Deposit%20netting.pdf> (accessed 19.03.2023).

³⁴ The European Financial Markets Lawyers Group conducted a comparative analysis of various master agreements' provisions on close-out netting with a particular emphasis on the determination of fair values, termination currency, fallbacks for determination of securities market values and discretion granted to the non-defaulting party. The scope of analysis included ISDA 1992, ISDA 2002, GMRA 1995, GMRA 2000, GMSLA 2009, and EMA 2004.

³⁵ For instance, in accordance with the definitions section of IFEMA, "Insolvency Proceeding" means a case or proceeding seeking a judgment of or arrangement for insolvency, bankruptcy, composition, rehabilitation, reorganization, administration, winding-up, liquidation or other similar relief with respect to the Defaulting Party or its debts or assets, or seeking the appointment of a trustee, receiver, liquidator, conservator, administrator, custodian or other similar official (each, a "Custodian") of the Defaulting Party or any substantial part of its assets, under any bankruptcy, insolvency or other similar law or any banking, insurance or similar law governing the operation of the Defaulting Party". Thus, a flexibility with respect to insolvency proceedings taking place in various jurisdictions is effectively achieved.

³⁶ For example, automatic termination of transactions is a statutory requirement in Germany and Japan while under Hong Kong law automatic termination of transactions is not necessary to achieve the aims of close-out netting. See: Miller E., Usher G. Commentary on the ISDA Master Agreements. – *Fieldfisher.com*. February 4, 2008. URL: <http://www.fieldfisher.com/pdf/commentary-isd-master-agreements.pdf> (accessed 19.03.2023).

In contrast to securities repurchase and lending transactions forwards and options on foreign currency market do not have embedded security per se. Although a risk-reduction effect of close-out netting and other netting types is quite obvious these contractual instruments are not able to eliminate uncertainties pertaining to financial transactions. After netting is close-out netting is applied, one of the parties is still exposed to the payment of the net amount. To be on the safe side, alongside netting the parties use so-called financial collateral in the form of cash and liquid securities. Collateral terms are very sensitive, therefore collateral arrangements involving New York law may be negotiated for more than a year. On the whole, collateral annexes are widely spread in international and domestic financial markets.

ISDA Credit Support Annex (CSA) traditionally plays the role of a risk mitigator and security under derivatives transactions. CSA envisages the opportunity to mutually exchange variation margin in the form of cash and securities in case the balance of mutual obligations shifts and is currently available in two major forms. 1995 ISDA Credit Support Annex (Transfer – English Law) is exclusively governed by English law while pledge exists in two forms under the laws of England and Wales as well as under the laws of the State of New York. Other examples of annexes to standard master agreements facilitating the use and transfer of financial collateral include collateral documentation of the European Banking Federation and German banking union. Russian standard documentation which is essentially based on ISDA templates also includes an agreement governing the transfer of margin amounts under Russian law. The collateral is provided using 1999 collateral annex to FEIMA, IFEMA or ICOM Master Agreement (Collateral Annex)³⁷.

Collateral Annex provides model contractual terms for collateralization of foreign currency forwards and options through one-way delivery of col-

lateral. As the annex is governed by New York law³⁸, FXC obtained relevant enforceability opinion from a prominent law firm Sullivan & Cromwell³⁹ and made it freely available⁴⁰. The opinion states that the annex constitutes “valid and legally binding obligation of each party enforceable against such Party in accordance with its terms subject to bankruptcy, insolvency conservatorship, receivership, fraudulent transfer, reorganization, moratorium and similar laws of general applicability relating to or affecting creditors’ rights and to general equity principles”⁴¹.

Under the annex a security interest is created in the form of first priority continuing security interest in collateral⁴². The collateral can be delivered in cash and US treasury securities although the parties may designate any kind of security they see fit. Despite the existence of security interest in collateral, the parties may sell, pledge, assign, invest, use, and commingle collateral giving the parties the necessary degree of flexibility. To reflect the needs of the parties in a more precise manner, an independent amount, a threshold amount and the minimum delivery amount may be selected.

5. Governing law and enforceability issues.

According to the governing law clauses of FXC agreements the parties thereto are free to choose from English law, the laws of the State of New York and Japan. The existence of governing law clause is hard to underestimate due to ambiguity surrounding the determination of applicable law with respect to master agreements in absence of parties’ choice. Private international law of the European Union whose contract law is unified based on Rome I Regulation⁴³ contains clause 3(1) of providing that a contract may be governed by the law chosen by the parties. Similar provisions embracing the party autonomy in selecting applicable law are present in other statutes on conflict of laws⁴⁴ as most jurisdiction follow the same

³⁷ The Financial Markets Lawyers Group: Collateral Annex. URL: <https://www.newyorkfed.org/fmlg/documentation/collateral.html> (accessed 19.03.2023).

³⁸ See clause 8.2 of the Collateral Annex.

³⁹ The firm was established in 1879 and is headquartered in New York. URL: <http://www.sullcrom.com> (accessed 19.03.2023).

⁴⁰ The Financial Markets Lawyers Group: Sullivan and Cromwell opinion. URL: <https://www.newyorkfed.org/medialibrary/microsites/fmlg/files/legalenforceopinion.pdf> (accessed 19.03.2023).

⁴¹ See clause 3 of the Sullivan and Cromwell opinion.

⁴² Clause 2.1 of the Collateral Annex.

⁴³ European Union: Regulation (EC) No 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations (Rome I). URL: <http://eur-lex.europa.eu/legal-content/en/ALL/?uri=CELEX%3A32008R0593> (accessed 19.03.2023).

⁴⁴ Bundesgesetz über das Internationale Privatrecht (IPRG) vom 18. Dezember 1987. URL: https://www.fedlex.admin.ch/eli/cc/1988/1776_1776_1776/de (accessed 19.03.2023).

approach [Böger 2013:238]. Given the importance of applicable law choice, FXC heavily relies on the conflict-of-laws principle, *lex voluntatis*.

An organic development of the freedom of contract, this principle allows the parties to elect the applicable law in the agreement either explicitly or implicitly, and the law chosen may have no relation to any of the parties, as well as the place of contract execution or performance. Sometimes the choice of law may not guarantee the application of all the rules existed in the law selected by the parties. Public policy argument may intervene either on the dispute resolution stage or during the recognition and enforcement of the court decision. Moreover, overriding rules of domestic law may be directly applicable and they capable of compromising the functioning of law chosen by the parties.

Financial master agreements generally contain choice-of-law provisions, and it is typical for an international master agreement to expect that the parties elect the governing law of the contract [Böger 2013:237]. For these purposes, the law of England and Wales or the laws of the State of New York is usually chosen⁴⁵, and ISDA master agreements is a valid example of such a solution to the conflict-of-laws problem. However, considering Brexit ISDA published versions of its agreements under French⁴⁶ and Irish law⁴⁷. GMRA is exclusively governed by English law while GMSLA follows the same pattern⁴⁸.

Generally, Russian banks and corporates are free to conclude any agreement they deem appropriate and make these selections. Private international law rules related to the choice of laws are present in the Civil Code of the Russian Federation (Part III). Relevant articles include article 1210 (choice of law by the parties to the contract), 1211 (the law applicable to the contract in absence of the agreement on choice of law between the parties) and 1215 (the scope of

the law applicable to the contract). *Lex voluntatis* is the natural consequence of a more general principle of the private law, the freedom of contract. In accordance with article 1210 the parties are free to choose any law.

Therefore, Russian court will uphold the choice of English, New York or Japanese law as well as any other choice of law made by the parties to FXC master agreements in case the parties chose Russian court as a dispute resolution venue instead of English, Japanese or New York courts⁴⁹ as recommended by the drafters of FXC documentation⁵⁰. This is even more notable given that some countries do not embrace *lex voluntatis* to the full extent [Böger 2013:237]. Notable exceptions include China and USA that require some degree of connection with the legal system of a country whose law is chosen as the governing law of the contract [Böger 2013:241].

Although the default FXC master agreements jurisdiction clauses set out state courts as a jurisdiction venue, arbitration clauses are also used in OTC financial markets. The case of ISDA shows that arbitration clauses may replace default dispute resolution provisions in the ISDA Master Agreement⁵¹. Given that Russia is the participant of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards⁵², the arbitral award with respect to a dispute involving FXC agreement may be enforced in Russia subject to usual reservations. However, FXC documentation lacks applicable court practice to give the degree of predictability that professional participants of international financial markets may seek. Moreover, enforceability of netting and collateral provisions present in FXC documentation depends on the rules of local bankruptcy law. When a counterparty goes insolvent, the validity of contractual provisions is derived from *lex contractus*, but their effect within insolvency proceedings is dependent on *lex fori con-*

⁴⁵ See Part 4 of the Schedule to 1992 and 2002 ISDA Master Agreements stating that the agreement will be governed by and construed in accordance with English law or the laws of the State of New York (without reference to choice of law doctrine).

⁴⁶ The 2002 ISDA Master Agreement (French Law). URL: <https://www.isda.org/book/2002-isda-master-agreement-french-law-pdf/> (accessed 22.05.2023).

⁴⁷ The 2002 ISDA Master Agreement (Irish Law). URL: <https://www.isda.org/book/2002-isda-master-agreement-irish-law-pdf/> (accessed 22.05.2023).

⁴⁸ See paragraph 17 GMRA and paragraph 23.1 GMSLA 2010.

⁴⁹ The jurisdiction is selected in the jurisdiction clauses of FXC agreements. See e.g. the jurisdiction clauses of ICOM and adherence agreement

⁵⁰ Subject to public policy exception and overriding mandatory rules of domestic law (articles 1193 and 1192 of the Civil Code of the Russian Federation)

⁵¹ The 2018 ISDA Arbitration Guide URL: <https://www.isda.org/a/fVWgE/ISDA-2018-Arbitration-Guide---Version-2.1-May-31-2022.pdf> (accessed 19.03.2023).

⁵² UNCITRAL: Status: Convention on the Recognition and Enforcement of Foreign Arbitral Awards. URL: https://uncitral.un.org/en/texts/arbitration/conventions/foreign_arbitral_awards/status2 (accessed 19.03.2023).

cursus. The latter may contain a myriad of provisions compromising the operation of close-out netting starting with cherry picking rights of the insolvency administrator and ending with insolvency set-off prohibition.

As close-out netting resembles insolvency set-off, those jurisdictions opposed to that insolvency instrument are potentially toxic for master agreements based on close-out netting mechanism. Cherry-picking rights is another example of insolvency impediments in the way of effective close-out netting functioning⁵³. An insolvency administrator or similar official is vested with rights to assume or reject contracts and leases of an insolvent debtor. Master agreement is aimed to produce multiple derivative transactions with different financial results depending on the underlying rates, prices, indexes and other parameters. Since those rates are potentially volatile, some of the master agreement transactions may be in-the-money (meaning profitable) for the insolvency debtor while others are out-of-the money. Therefore, a person supervising the bankruptcy proceedings is interested in assuming profitable contracts and rejecting those appearing to the detriment of the insolvent entity.

Russian rules aimed at close-out netting enforceability are embedded into Federal Law No. 127-FZ dated 26 October 2002 “On Insolvency (Bankruptcy)” (the “Russian Insolvency Law”) and contain provisions achieving the prevention of cherry picking and application of insolvency set-off restriction to close-out netting. However, the list of associations drafting recognized agreements is quite short and is currently limited to ISDA, ICMA and Futures Industry Association⁵⁴. All other standard master agreements including those published by FXC remain in the grey area. As a side note, UNIDROIT does not recommend restricting the list of industry agreements for financial transactions for the purposes of close-out netting⁵⁵, and FXC master agreements rec-

ognition by the Russian regulators will be a valuable step in bringing Russian laws in compliance with the approach adopted by UNIDROIT.

Another sensitive issue is the link between close-out netting enforceability under FXC Agreements and their reporting to National Settlement Depository (NSD), Russian licensed trade repository collecting information on operations with derivatives in line with the recommendations adopted at G20 Pittsburgh Summit back in 2009⁵⁶. Although NSD added FXC Agreements to the list of acceptable standard contracts alongside ISDA contractual templates⁵⁷, FXC Agreements lack necessary language incentivizing Russian counterparties to report information on their conclusion to Russian repository. The representatives of the Central Bank of Russia opined on the reasonability of lifting the provision of information to trading repository as the requirement for close-out netting enforceability⁵⁸, however the relevant provisions of Russian Insolvency Law still remain in force. Thus, de-linkage of netting and reporting represents another area for legislative reform benefiting potential users of FXC Agreements.

7. Conclusion

FXC master agreements provide a great variety of templates for derivative transactions involving foreign currency. Following recent trends in foreign exchange markets FXC shifted from issuing separate master agreements for various kinds of foreign exchange products to one single agreement, IFXCO. Neither separate master agreements produced by FXC, nor IFCXO can successfully compete with ISDA templates. Nevertheless, in case financial institutions wish to avoid complexity in structuring their commercial relationship involving foreign currency trades, FXC contractual templates prove to be an option to consider. FXC master agreements suggest risk mitigation tools such as close-out netting and col-

⁵³ ISDA: The description of cherry picking can be found in the letter of ISDA to Chilean Central Bank. URL: <https://www.isda.org/a/iPiDE/letter-to-chilean-central-bank.pdf> (accessed 19.03.2023).

⁵⁴ Bank of Russia Ordinance No. 5516-U dated July 29, 2020 “On Approval of the List of Foreign Organizations Developing (Approving) Exemplary Terms of an Agreement (Other Similar Documents) for the Purpose of Applying Clause 5 of Article 51.5 of Federal Law No. 39-FZ dated April 22, 1996 “On the securities market”. (In Russ.). URL: http://www.consultant.ru/document/cons_doc_LAW_361457/ecc4997dde51a91f553b87a44a80f1d5163f16e9/ (accessed 22.05.2023).

⁵⁵ UNIDROIT: Principles on the operation of close-out netting provisions. URL: <https://www.unidroit.org/instruments/capital-markets/netting/> (accessed 22.05.2023).

⁵⁶ G20 Leaders Statement: The Pittsburgh Summit. URL: <http://www.g20.utoronto.ca/2009/2009communique0925.html> (accessed 19.03.2023).

⁵⁷ MOEX: Album of paper forms of messages. URL: <https://repository.nsd.ru/services/printforms> (accessed 19.03.2023).

⁵⁸ The view was expressed by the Bank of Russia Financial Market Development Department employees E. Abasheeva and A. Teplova in 2015 URL: <http://www.cbr.ru/content/document/file/95549/reporting.pdf> (accessed 19.03.2023).

lateral matching best standards in financial markets and making it a contractual standard capable to be used in international financial markets. Unfortunately, FXC agreements cannot be successfully enforced within Russian insolvency proceedings against Rus-

sian counterparty making a reform in that field necessary. In turn, this could facilitate transactions in foreign currency with financial institutions from those countries which did not join to foreign sanctions against Russia⁵⁹.

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⁵⁹ FMLG carries out the publication of legal opinions on the enforceability of netting. Those opinions are mainly given with respect to the countries that joined sanctions campaign against Russia, but there are notable exceptions such as Hong Kong, Malaysia, Philippines, Singapore, South Africa and Thailand. URL: <https://www.newyorkfed.org/fmlg/legal/opinions.html> (accessed 22.05.2023).