International Comparative Legal Guides

Derivatives 2021

A practical cross-border insight into derivatives

Second Edition

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Expert Analysis Chapters

1 **Smart Contracts in the Derivatives Space: An Overview of the Key Issues for Buy-side Market Participants**
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5 **Japanese Yen Interest Rate Benchmark Reform – Will the Multiple Paths Under the Multiple Benchmark Rate Regime in Japan Converge?**
Yusuke Motoyanagi & Toshiyuki Yamamoto, Nishimura & Asahi

11 **The Indispensable Swap Coordinator**
Felicity Caramanna, Credit Agricole Corporate and Investment Bank

Q&A Chapters

16 **Australia**
Gilbert + Tobin: Louise McCoach

23 **Canada**
Cassels Brock & Blackwell LLP: Charles Newman, Mike Tallim & Richard Ngo

30 **Cayman Islands**
Maples Group: Tina Meigh & Hailee Robinson

35 **England & Wales**
Travers Smith LLP: Jonathan Gilmour & Vanessa Kalijnikoff Battaglia

45 **France**
Jeantet AARPI: Jean-François Adelle & Thibault Mercier

54 **Germany**
Hengeler Mueller: Stefan Krauss & Christian Schmies

61 **Hong Kong**
Mayer Brown: Vincent K.P. Sum & Shirley L. Huang

68 **India**
Crawford Bayley & Co.: Bhumika Batra

73 **Israel**
Meitar | Law Offices: Cliff Felig, David S. Glatt, David Dydek & Hodiya Schnider

78 **Japan**
Nagashima Ohno & Tsunematsu: Ichiro Oya, Masayuki Fukuda, Hideaki Suda & Tsutomu Endo

85 **Luxembourg**
GSK Stockmann: Andreas Heinzmann & Valerio Scollo

91 **Portugal**
CARDIGOS: Pedro Cardigos, Maria Almeida Fernandes & Sara Santos Dias

98 **Spain**
Cuatrecasas: Tania Esteban & Arnau Pastor

107 **USA**
Paul, Weiss, Rifkind, Wharton & Garrison LLP: Manuel S. Frey & Anastasia V. Peterson

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1 Documentation and Formalities

1.1 Please provide an overview of the documentation (or framework of documentation) on which derivatives transactions are typically entered into in your jurisdiction. Please note whether there are variances in the documentation for certain types of derivatives transactions or counterparties; for example, differences between over-the-counter ("OTC") and exchange-traded derivatives ("ETD") or for particular asset classes.

Derivatives transactions in Spain are mostly formalised by virtue of a master agreement together with its corresponding schedules, a confirmation for the specific transaction and, when applicable, a title transfer collateral form. The documentation package to be used in a transaction may differ between two different standard templates.

When one of the parties is not Spanish and/or if the underlying transaction is not governed by Spanish law, parties typically use the master agreement published by the International Swaps and Derivatives Association ("**ISDA**"), as well as its protocols and definitions booklets.

However, in Spanish banking practice, the Financial Transaction Framework Agreement is widely used, commonly known as the "**CMOF**" for its acronym in Spanish (*Contrato Marco de Operaciones Financieras*). The CMOF is a standard form of framework agreement for financial derivatives transactions governed by Spanish law and drafted only in the Spanish language, broadly used between Spanish counterparties, which follows the same scheme of other international framework agreements for contractual clearing (such as ISDA).

The CMOF was initially drawn up in 1997 by the Spanish Banking Association (*Asociación Española de Banca*, or "**AEB**"), which brings together the majority of Spanish banks, and has been subsequently updated by the AEB and CECA (*Confederación Española de Cajas de Ahorros*) in 2009, 2013 and most recently in 2020.

The CMOF is structured much like ISDA, namely: (i) a framework agreement; (ii) a Schedule I for modifications to the general provisions contained in the framework agreement; (iii) a Schedule II for specific definitions; (iv) if applicable, a Schedule III for the collateral transfer and variation margin ("**VM**"); (v) if applicable, a Schedule IV for the clearing agreement; (vi) if applicable, a Schedule V for the initial margin ("**IM**"); and (vii) confirmations of the transactions.

1.2 Are there any particular documentary or execution requirements in your jurisdiction? For example, requirements as to notaries, number of signatories, or corporate authorisations.

Derivatives documentation may be executed in private by authorised signatories of the counterparties (such capacity of the signatories to grant the relevant documents shall be proved to one another).

However, it is generally accepted to notarise ISDA/CMOF agreements since notarisation provides certainty of the date and content of the applicable document *vis-à-vis* third parties. Moreover, the relevant notary public conducts – prior to signing – an analysis of the capacity of the signatories.

In particular, notarisation is especially advisable when a guarantee or a security is granted in relation to the transaction, given that notarisation allows the notarised agreements to qualify as executive title (*título ejecutivo*) pursuant to article 517 of the Spanish Law on Civil Procedure (*Ley de Enjuiciamiento Civil*). This may allow the non-defaulting party to accede to a judicial executive enforcement procedure (*procedimiento ejecutivo*). Otherwise, in a judiciary enforcement scenario related to a non-notarised document, the non-defaulting party – as claimant – would first be required to claim all amounts due through an ordinary/declaratory proceeding (*procedimiento declarativo*) and, following such proceeding (assuming a ruling in favour of the claimant is obtained), then enforce the ruling through an executive enforcement procedure.

On a separate note, it should be noted that when formalising public documents in Spain, the parties' representatives must prove their capacity as representatives to the notary public by showing powers of attorney (general or special) or, in the case of corporate representation bodies, reliable documents proving their representative powers. In this regard, considering the risk attributable to derivatives transactions, notaries may not accept general powers of attorney or general faculties assigned to a representative, but may request specific mentions – in the relevant powers or corporate resolutions – to the capacity of an individual to subscribe derivatives transactions.

1.3 Which governing law is most often specified in ISDA documentation in your jurisdiction? Will the courts in your jurisdiction give effect to any choice of foreign law in the parties' derivatives documentation? If the parties do not specify a choice of law in their derivatives contracts, what are the main principles in your jurisdiction that will determine the governing law of the contract?

To date, in Spain, English law is the governing law most often

chosen when formalising derivatives transactions subject to ISDA documentation. However, since Brexit, there is a certain trend towards choosing Irish or French law.

Courts in Spain will recognise a foreign governing law in derivatives documentation in line with Regulation (EC) No. 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations (the "**Rome I Regulation**"). The Rome I Regulation has *erga omnes* effects. Hence, whatever it is, the foreign law chosen to govern a contract is enforceable, irrespective of whether or not it is an EU Member State.

Spanish courts will certainly recognise a contract governed by foreign law. However, according to article 9 of the Rome I Regulation, the principle of party autonomy has certain restrictions, such as restrictions due to the overriding mandatory provisions. In this regard, the Court of Justice of the European Union (C-369/96 and C-135/15) has deemed "overriding mandatory provisions" as the rules that a country considers essential for safeguarding its public interest.

In this regard, Spanish courts may refuse the application of the chosen law if the relevant provisions are clearly contrary to Spanish public policy. In this situation, the relevant Spanish court would apply the relevant provisions under Spanish law instead of those applicable under the chosen foreign law.

On the other hand, the principle of party autonomy may be limited when the chosen law is the law of a non-EU Member State and all the relevant elements in the contract are located in one or more Member State(s). In this regard, the choice of the parties regarding the applicable law may not prejudice the application of mandatory provisions under EU law. That said, this restriction would not normally apply in case of commercial relationships such as those between two professionals (companies being counterparties under an ISDA/CMOF agreement), taking into account the regular content of those agreements.

If no governing law is specified in a derivatives contract, the relevant judge will have to determine the applicable law according to different aspects (i.e., residence of the parties, and the place where the services are rendered or the assets located).

2 Credit Support

2.1 What forms of credit support are typically provided for derivatives transactions in your jurisdiction? How is this typically documented? For example, under an ISDA Credit Support Annex or Credit Support Deed.

The typical forms of credit support annex ("**CSA**") in derivatives transactions in Spain are: (i) guarantees; (ii) security interests; and (iii) collateral agreements in the form of the ISDA Credit Support Annex when the derivatives documentation is subject to English law, or Schedule III to the CMOF (*Acuerdo de Realización de Cesiones en Garantía*) when it is subject to Spanish law.

The most common collateral agreement under English law is a CSA in the form of the 1995 ISDA Credit Support Annex (Transfer – English Law).

Where the parties are required to exchange VM and/or IM pursuant to Regulation (EU) No. 648/2012 (the European Market Infrastructure Regulation, or "**EMIR**"), ISDA has produced additional credit support documents such as the ISDA 2016 Credit Support Annex for VM (Transfer – English Law), the 2016 Phase One IM Credit Support Deed (Security Interest – English Law) and the 2018 Credit Support Deed for IM (Security Interest – English Law). Following the same scheme of the abovementioned ISDA collateral agreements, the AEB and CECA have produced an additional Schedule III for VM (*Acuerdo de Realización de Cesiones en Garantía en concepto de Margen de Variación*) and a Schedule V for IM (*Acuerdo de Garantía Financiera Pignoraticia en concepto de Margen Inicial*).

2.2 Where transactions are collateralised, would this typically be by way of title transfer, by way of security, or a mixture of both methods?

Collateral agreements in the form of the 1995 ISDA Credit Support Annex operate by way of title transfer.

Under Spanish law, Schedule III of the CMOF qualifies as a financial collateral arrangement (*garantía financiera*) in accordance with Royal Decree-Law 5/2005, of 11 March, on urgent reform measures to encourage productivity and improve public sector procurement (*Real Decreto-ley 5/2005, de 11 de marzo, de reformas urgentes para el impulso a la productividad y para la mejora de la contratación pública*) ("**Royal Decree-Law 5/2005**"), and operates by way of title transfer.

Any transfer of collateral made by a party under said Schedule III, whether it is cash, public debt or other negotiable securities, shall be considered an "assignment". Thus, such transfer entails the transfer to the recipient of the full ownership and dominion thereof, free of all charges and encumbrances (except for those *in rem* rights or retention rights imposed by the relevant clearing and settlement system of securities, as the case may be). For further details, refer to paragraph 2 of question 2.6 below.

2.3 What types of assets are acceptable in your jurisdiction as credit support for obligations under derivatives documentation?

In general, parties are free to agree and determine the nature of the assets to be transferred as credit support. The most common exchanged credit support is cash (the predominant currencies being the Euro, USD or GBP), but also promissory notes (*pagarés*), bonds issued by private corporations or national governments (such as American, German, French or Spanish bonds) and other transferable securities.

In this point, in relation to regulatory margin arrangements, it is worth noting that EMIR establishes a set of criteria that certain assets must comply with in order to be admitted as eligible collateral to be used as IM or VM. For further details, refer to question 2.5 below.

2.4 Are there specific margining requirements in your jurisdiction to collateralise all or certain classes of derivatives transactions? For example, are there requirements as to the posting of initial margin or variation margin between counterparties?

The specific margining requirements to collateralise certain classes of derivatives transactions are established by EMIR. Said regulation obliges to counterparties that fall under its scope to exchange margin on the OTC derivatives transactions that are not subject to clearance via central counterparty ("**CCP**"). At this stage, it should be noted that financial counterparties ("**FCs**"), such as banks, credit institutions, alternative investment funds, UCITS, certain pension scheme arrangements and insurance providers, and non-financial counterparties above the clearing threshold ("**NFC+s**"), are subject to more onerous margining requirements.

EMIR margining requirements are divided in two different categories:

(a) **IM**: When collateral is used as IM, the exchange of margining requirement is triggered by the occurrence of certain events and aside from the own assets of the collecting party (normally held in a custodian).
Regarding IM documents, due to the fact that parties have to comply with EMIR as well as the relevant custodian arrangements, they typically enter into the 2016 Phase One IM Credit Support Deed (Security Interest – English Law) or the 2018 Credit Support Deed for IM (Security Interest – English Law), together with other additional documentation such as custody agreements.

(b) **VM**: When collateral is used as VM, the exchange of margining requirement is produced on a daily basis and based on the mark-to-market value of the relevant OTC derivative.

Regarding VM documents, parties in Spain commonly use the ISDA 2016 Credit Support Annex for VM (Transfer – English Law) to comply with the EMIR VM margining requirement.

As per the CMOF, in order to capture the margining requirements according to EMIR, the AEB and CECA have produced an additional Schedule III for VM and a Schedule V for IM.

2.5 Does your jurisdiction recognise the role of an agent or trustee to enter into relevant agreements or appropriate collateral/enforce security (as applicable)? Does your jurisdiction recognise trusts?

Security interests are normally granted in favour of the security agent on behalf of the secured creditors, which will, in the event of default, enforce the security interest on their behalf. However, Spanish law expressly recognises neither the concept of security agent nor the concept of trustee, and the security agency or security trustee structure may not be recognised by Spanish courts. Therefore, where an entity acts as security agent of the actual beneficiaries of the security interest or a guarantee (i.e., the creditors of the secured obligations), it must be duly empowered at the time it acts as security agent or trustee. Otherwise, the security interest or guarantee will not be validly created in favour of its purported beneficiaries.

2.6 What are the required formalities to create and/or perfect a valid security over an asset? Are there any regulatory or similar consents required with respect to the enforcement of security?

The formalities to perfect and create a valid security in Spain depend on the type of asset that may be subject to the security. The most commonly used types of collateral in the framework of derivatives transactions are generally classified into two main groups:

(1) ***In rem* security interests**, the most frequent being ordinary pledges over movable assets with transfer of possession (*prenda ordinaria*) (e.g., pledge over shares, over credit rights or over bank accounts), but also non-possessory pledges over assets (*prenda sin desplazamiento de la posesión*) or, less commonly used in derivatives transactions, mortgages over real estate assets (*hipoteca inmobiliaria*) or chattel mortgages (*hipoteca mobiliaria*).
Perfection of possessory pledges (so-called ordinary pledges) requirea that the pledgor "transfers the possession" of the asset to the pledgee or to a third party (as appointed by the pledgor and pledgee (e.g., a security agent)).
Generally speaking, to perfect a possessory pledge, the following requirements must be met: (i) the notarisation of the agreements by means of which they are granted; and (ii) specific formalities based on the specific type of asset (e.g., a notice to the depositary bank in case a bank account is pledged or, in case of pledges over quota shares (*participaciones*), to record the pledge in the ownership deeds/titles of the quota shares).
Notarial documents (being either notarial deed – *pólizas notariales* – or public deed – *escrituras públicas*) provide certainty of the date and content of the relevant document *vis-à-vis* third parties. Notarisation allows the agreements to qualify as executive title in an enforcement scenario pursuant to article 517 of the Spanish Law on Civil Procedure, and therefore any notarised agreement would be directly enforceable. In this regard, note that a pledge created under a foreign law (other than Spanish law) will be valid; however, it is important to note that, in such a case, it will be necessary to execute a document equivalent to a Spanish notarial or public deed in an enforcement scenario in Spain, as a document that only legalises the pledgor signature will not be sufficient.
Further formalities for the abovementioned security involve the registration of such security with the corresponding Spanish registries: the Property Registry (*Registro de la Propiedad*) with regard to real estate mortgages; and the Chattel Registry (*Registro de Bienes Muebles*) with regard to non-possessory pledges.

(2) **Financial collaterals**. Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements was transposed in Spain by means of Royal Decree-Law 5/2005. Royal Decree-Law 5/2005 sets forth a speedy proceeding that applies to obligations of a "financial" nature and permits direct appropriation of the collateral by the creditor where the financial agreement expressly states so, meaning that, in an enforcement scenario, the secured party may perform the direct sale (without following court or out-of-court enforcement proceedings) of the asset.
In any case, with respect to dealers, all applicable European regulations on the recovery and resolution of credit institutions and investment firms under Directive 2014/59/EU (the "**BRRD**"), as implemented in Spain by Law No. 11/2015 of 18 June 2015, and Royal Decree 1012/2015 of 6 November 2015, must be observed.
Royal Decree-Law 5/2005 provides that financial collateral must be in written form and no additional formality should be required to perfect financial collaterals (there is no need to execute the documentation as a notarial document). However, as a matter of practice, it is customary to perform the same perfection requirements explained for possessory pledges when creating a financial collateral (i.e., a notarial document and specific formalities depending on the type of asset given as security).
Under Spanish law, Schedule III of the CMOF qualifies as a financial collateral arrangement in accordance with Royal Decree-Law 5/2005.

3 Regulatory Issues

3.1 Please provide an overview of the key derivatives regulation(s) applicable in your jurisdiction and the regulatory authorities with principal oversight.

Derivatives regulation in Spain is made up of two different blocks of applicable legislation, this being European and Spanish regulation.

European level

The most relevant European regulations are, in general, the following: (i) Regulation (EU) No. 2019/2099 of the European Parliament and of the Council of 23 October 2019, amending Regulation (EU) No. 648/2012 as regards the procedures and authorities involved for the authorisation of CCPs and requirements for the recognition of third-country CCPs ("**EMIR II**"); (ii) Regulation (EU) No. 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, CCPs and trade repositories ("**EMIR**"); (iii) Regulation (EU) No. 2019/834 of the European Parliament and of the Council of 20 May 2019, amending Regulation (EU) No. 648/2012 as regards the clearing obligation, the suspension of the clearing obligation, the reporting requirements, the risk-mitigation techniques for OTC derivatives contracts not cleared by a CCP, the registration and supervision of trade repositories and the requirements for trade repositories ("**EMIR RTS**"); (iv) Regulation (EU) No. 1227/2011 of the European Parliament and of the Council of 25 October 2011 on wholesale energy market integrity and transparency; (v) Regulation (EU) No. 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments, amending Regulation (EU) No. 648/2012 ("**MiFIR**"); and (vi) Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on Markets in Financial Instruments ("**MiFID II**").

EMIR II, EMIR and EMIR RTS encompass different requirements such as the obligation of clearing certain OTC derivatives transactions through CCPs (amongst others, specific interest rate and credit derivatives), establishing collateral requirements and other risk mitigation techniques for non-centrally cleared OTC derivatives, as well as foreseeing reporting obligations to trade repositories.

MiFIR and MiFID II set out a general framework for investment firms that trade derivatives and provide rules for the improvement of investor protection and greater standards of transparency.

Local level

In Spain, the key derivatives regulations are composed of: (i) Royal Legislative Decree 4/2015 of 23 October, approving the Spanish Securities Market Act (*Real Decreto Legislativo 4/2015 de 23 de octubre, por el que se aprueba el texto refundido de la Ley del Mercado de Valores*); (ii) Royal Decree-Law 14/2018 of 28 September, amending the revised text of the Securities Market Act (*Real Decreto-ley 14/2018 de 28 de septiembre, por el que se modifica el texto refundido de la Ley del Mercado de Valores*); and (iii) Royal Decree-Law 5/2005 of 11 March on urgent reform measures to encourage productivity and improve public sector procurement (*Real Decreto-ley 5/2005 de 11 de marzo de reformas urgentes para el impulso a la productividad y para la mejora de la contratación pública*).

It should be noted that Royal Decree-Law 5/2005 transposes, amongst others, Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements. In this regard, Royal Decree-Law 5/2005 regulates (in a harmonised way throughout the EU) contractual netting agreements and financial collateral, allowing contracting parties to benefit from certain advantages (in comparison with ordinary security) such as greater simplicity in its formalisation/perfection or a speedy enforcement proceeding. In order to constitute a financial collateral under Royal Decree-Law 5/2005, one of the parties must be a credit institution subject to public authorisation and supervision and, generally speaking, the other party must be a company.

Schedule III of the CMOF is based on the financial collateral regulated by Royal Decree-Law 5/2005.

As for regulatory authorities, at a European level, the main relevant authority in charge of safeguarding the stability of the EU's financial system is the European Securities and Markets Authority ("**ESMA**"). ESMA proposes rules on derivatives, CCPs and trade repositories, and closely monitors the derivatives market in the EU.

The Spanish regulatory authority in charge of the supervision of the derivatives market is the Spanish National Securities Market Commission (*Comisión Nacional del Mercado de Valores*, or "**CNMV**"), supervising and monitoring trading volumes as well as establishing trading limits when applicable. The main regulator of dealers and trading entities operating in the market is the CNMV and, if the dealer/entity is a credit institution, also the Bank of Spain (or European Central Bank as applicable).

3.2 Are there any regulatory changes anticipated, or incoming, in your jurisdiction that are likely to have an impact on entry into derivatives transactions and/or counterparties to derivatives transactions? If so, what are these key changes and their timeline for implementation?

As foreseen under Regulation (EU) No. 2016/1011 of the European Parliament and of the Council of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds, amending Directives 2008/48/EC and 2014/17/EU and Regulation (EU) No. 596/2014 (the "**EU Benchmark Regulation**"), administrators that provide critical benchmarks (as defined in article 20) must comply with the EU Benchmark Regulation before 31 December 2021, meaning that entities under the supervision of the EU will not be allowed to use benchmarks that are not managed or published by supervised entities duly authorised by the relevant European/local authorities. Accordingly, critical benchmarks will have to receive the relevant authorisation so that they can be referenced as a valid benchmark in derivatives contracts.

The above has led to the publication of several standards and forms to adapt the existing documentation in order to anticipate the cessation of the publication of certain critical benchmarks. With regard to the ongoing ISDA agreements, the ISDA 2018 Benchmarks Supplement Protocol and the ISDA 2020 IBOR Fallbacks Protocol have resulted in the most significant contractual implementations. The parties to the current derivatives ISDA agreements are considering (i) adherence to said protocols, (ii) bilaterally incorporating all the protocol content through bilateral agreements, and (iii) amending the existing ISDA documentation (via Schedule I or the confirmation).

Regarding the CMOF, in order to capture the upcoming changes in the applicable benchmarks, a standard form of novation agreement has been published, as well as an additional schedule that incorporates a set of definitions to the CMOF.

3.3 Are there any further practical or regulatory requirements for counterparties wishing to enter into derivatives transactions in your jurisdiction? For example, obtaining and/or maintaining certain licences, consents or authorisations (governmental, regulatory, shareholder or otherwise) or the delegating of certain regulatory responsibilities to an entity with broader regulatory permissions.

As foreseen under EMIR, counterparties wishing to enter into OTC derivatives transactions must comply with the following obligations:

(a) Clearing: According to article 4 of EMIR, counterparties must clear, through a CCP, all the OTC derivatives

contracts that fulfil the conditions established in such article and that, in virtue of article 5(2) of EMIR, belong to a class of derivatives that has been declared subject to the clearing obligation.

(b) Reporting: In virtue of article 9(1) of EMIR, counterparties (i.e., each counterparty, one FC on behalf of both counterparties or a third party) and CCPs are obliged to communicate by end of day T+1 following the conclusion, modification or termination of the contract, the details of any OTC derivatives contract and any modification or termination of such contract, to a trade repository registered under article 55 of EMIR or recognised in accordance with article 77 of EMIR.

(c) Record-keeping: According to article 9(1) of EMIR, counterparties must keep, for a minimum period of five years after termination of a derivatives contract, a record of the contract they have concluded and any modification.

3.4 Does your jurisdiction provide any exemptions from regulatory requirements and/or for special treatment for certain types of counterparties (such as pension funds or public bodies)?

Regarding the regulatory requirements established by EMIR and detailed in question 3.3 above, it is worth noting that EMIR is not applicable to the public bodies listed in articles 1(4) and 1(5) (e.g., the members of the European System of Central Banks, certain non-EU central banks, certain multilateral development banks, the European Financial Stability Facility or the European Stability Mechanism). In addition, certain intragroup derivatives transactions and certain pension scheme arrangements are exempt from the clearing obligation.

The exemption from the clearing obligation for certain pension scheme arrangements was initially foreseen by EMIR until 18 June 2021. However, such exemption is expected to be extended until 18 June 2022 in view of the Commission Delegated Regulation (EU) adopted on 6 May 2021, extending the transitional period referred to in article 89(1), first subparagraph, of Regulation (EU) No. 648/2012 of the European Parliament and of the Council.

4 Insolvency / Bankruptcy

4.1 In what circumstances of distress would a default and/or termination right (each as applicable) arise in your jurisdiction?

Financial entities may terminate derivatives agreements subject to Royal Decree-Law 5/2005 upon the insolvency declaration of the debtor.

- As opposed to the general regime (general ban on *ipso facto* clauses), article 16.1 of Royal Decree-Law 5/2005 allows the termination of derivatives agreements solely based on the insolvency declaration of the debtor.
- Pursuant to Spanish case law (Spanish Supreme Court ruling of 22 June 2018), the regime set forth in Royal Decree-Law 5/2005 (and hence the possibility to terminate the agreement early merely based on the insolvency declaration) can only be applied when the following circumstances are met: (i) existence of the CMOF; (ii) existence of a "plurality" of operations governed by the CMOF; and (iii) their respective liquidations being treated as a sole net balance, calculated in accordance with the terms of the CMOF.

4.2 Are there any automatic stay of creditor action or regulatory intervention regimes in your jurisdiction that may protect the insolvent/bankrupt counterparty or impact the recovery of the close-out amount from an insolvent/bankrupt counterparty? If so, what is the length of such stay of action?

Yes. The insolvency declaration brings about an automatic stay, which differs if security interest is in place or not.

General automatic stay (no security interest)

- Insolvency declaration brings about an automatic stay over payment, declaratory, and enforcement actions brought against the debtor. This general automatic stay lasts during the whole of the insolvency proceeding. The general automatic stay is only lifted upon the approval of a composition agreement (which will bind unsecured creditors).
- In case no security interest is in place, creditors will recover their insolvency claims (i) pursuant to the terms of the composition agreement proposed by the debtor (if approved by, at least, the unsecured creditors), or (ii) with the proceeds that might be obtained from the liquidation of the debtor.

Automatic stay on enforcement of security interest (not applicable to Royal Decree-Law 5/2005)

- The general regime is that, as per collateral that is necessary to pursue the ordinary course, repossession or auctions are also stayed upon declaration for one year, unless there is a composition agreement approved or the liquidation phase starts first.
- However, creditors subject to Royal Decree-Law 5/2005 escape this automatic stay. Accordingly, creditors holding security interest subject to Royal Decree-Law 5/2005 will be able to file or continue enforcement proceedings regardless of the insolvency declaration of the debtor.

4.3 In what circumstances (if any) could an insolvency/bankruptcy official render derivatives transactions void or voidable in your jurisdiction?

In Spain, the special regime established under Royal Decree-Law 5/2005, which transposed Directive 2002/47/EC on financial collateral arrangements, may apply to financial derivatives (if the conditions set forth in question 4.1 above are met) and also to the security package, if any. The application of the special regime foreseen in Royal Decree-Law 5/2005:

(i) prevents the insolvency official from voiding certain transfers of assets that the insolvent party had entered into within a certain period (two years) prior to the declaration of insolvency (mainly related to the guarantees provided, if any). In such a case, fraud must be proven; and

(ii) states that the insolvency official is the only one entitled to terminate derivatives agreements under the common clawback regime of the Spanish Recast Insolvency Law, and must provide evidence of the damage that the relevant derivative has caused to the insolvent company.

Notwithstanding the above, the scope of application of Royal Decree-Law 5/2005 and its effects are being narrowed by Spanish case law. The special regime (if applicable) foresees a super-privilege (unparalleled in the EU) that qualifies *ex lege* as post-petition claims (i.e., credits against the estate) those derived from an early maturity of the derivative once the insolvency has been declared and if it is not based on the insolvency declaration itself. The latter could give rise to opportunistic

behaviour *vis-à-vis* non-professionals. Therefore, in a protective attitude, the Spanish Supreme Court has determined that claims derived from derivatives will never qualify as post-petition claims because, even if they are bilateral agreements, they do not entail synallagmatic obligations.

In any event, the derivative may be void or voidable under the Spanish Civil Code (*Código Civil*). In the latter case, the term would be four years.

Should the special regime under Royal Decree-Law 5/2005 not be applicable to the relevant derivative, the general clawback regime under the Spanish Recast Insolvency Law will be. Please refer to question 4.4.

4.4 Are there clawback provisions specified in the legislation of your jurisdiction that could apply to derivatives transactions? If so, in what circumstances could such clawback provisions apply?

Yes, should the special regime not be applicable, the general clawback rule under the Spanish Recast Insolvency Law is the following: any action carried out or agreement entered into by the debtor in the two years preceding its declaration of insolvency (the "suspect period") may be rescinded (set aside) by the relevant insolvency court should the insolvency official have demonstrated that the action or agreement was "detrimental to the insolvency estate". Importantly, this may occur even if there is no fraudulent will.

As stated above in question 4.3, should the special regime apply, the insolvency official would be the only one entitled to file the clawback action (and would have to provide evidence of the harm). However, if the relevant derivative does not fall into the scope of Royal Decree-Law 5/2005, any insolvent company's creditor will also have legal standing (but this will be a subsidiary legal standing, i.e., if the insolvency official does not file the action after being requested to do so by the relevant creditor). Under Spanish law, there are absolute and relative presumptions regarding the detriment to the estate. In any other case (i.e., not falling in any of the presumptions), harm shall be demonstrated by the acting party.

In addition to the general clawback provisions, derivatives may be challenged by means of the general legal actions under Spanish law (but special rules regarding insolvency clawback actions such as legal standing, procedure and appeals will continue to be applicable).

4.5 In your jurisdiction, could an insolvency/bankruptcy-related close-out of derivatives transactions be deemed to take effect prior to an insolvency/bankruptcy taking effect?

Yes. In case the regime under Royal Decree-Law 5/2005 is applicable to the relevant derivative, under such rule there is a carve-out from Spanish bankruptcy law to allow for close-out of derivatives transactions to be performed prior to (or after) an insolvency/bankruptcy opening under article 16.1 of Royal Decree-Law 5/2005.

4.6 Would a court in your jurisdiction give effect to contractual provisions in a contract (even if such contract is governed by the laws of another country) that have the effect of distributing payments to parties in the order specified in the contract?

Agreements that have the effect of distributing payments to parties in the order specified in the contract, such as intercreditor agreements, will most likely not be recognisable in bankruptcy proceedings in Spain. Proceeds will be distributed pursuant to the liquidation plan drafted by the insolvency official and approved by the court. Notwithstanding this, such contract would still be binding *inter partes* and therefore, the potential lack of turning over the excess of proceeds in accordance thereof may give rise to a separate proceeding in a different court.

5 Close-out Netting

5.1 Has an industry-standard legal opinion been produced in your jurisdiction in respect of the enforceability of close-out netting and/or set-off provisions in derivatives documentation? What are the key legal considerations for parties wishing to net their exposures when closing out derivatives transactions in your jurisdiction?

Yes, there is a Spanish law netting opinion issued by DLA Piper as counsel of ISDA.

Under Spanish law, the netting provisions are valid and enforceable provided that the derivatives documentation fulfils the requirements set out in Royal Decree-Law 5/2005 to be considered a contractual netting agreement. For these purposes, the derivatives documentation should regulate a unique business relationship among the parties by virtue of which, and in case of early termination of the derivatives agreement, the parties shall only be entitled to demand of each other the net balance of the product obtained from the liquidation of the transactions executed thereunder.

5.2 Are there any restrictions in your jurisdiction on close-out netting in respect of all derivatives transactions under a single master agreement, including in the event of an early termination of transactions?

Article 5 of Royal Decree-Law 5/2005 expressly allows for close-out and netting of several derivatives transactions executed under a single master agreement, notwithstanding insolvency proceedings.

There is no consolidated case law, but the Supreme Court ruling of 18 November 2015 concluded that swap agreements only benefit from the special regime for insolvency established in Royal Decree-Law 5/2005 if the contractual netting agreement regulates multiple financial transactions. If the derivatives agreement fulfils this requirement, it will be considered a contractual netting agreement subject to Royal Decree-Law 5/2005.

In this case, the credit right derived from the termination of the derivatives agreement would be considered an ordinary insolvency credit, if the early termination was caused by a breach that occurred before the declaration of insolvency or by the declaration of insolvency itself.

However, if the breach occurred after the declaration of insolvency, the credit against the derivatives counterparty would be considered a credit against the insolvency estate, under article 126 of the Insolvency Act and article 16.2, second paragraph, of Royal Decree-Law 5/2005.

5.3 Is Automatic Early Termination ("AET") typically applied/disapplied in your jurisdiction and/or in respect of entities established in your jurisdiction?

Automatic Early Termination is typically disapplied in Spain due to the special insolvency regime applicable to those derivatives

agreements considered contractual netting agreements in accordance with Royal Decree-Law 5/2005 (see questions 4.1 to 4.6).

5.4 Is it possible for the termination currency to be denominated in a currency other than your domestic currency? Can judgment debts be applied in a currency other than your domestic currency?

The termination currency under derivatives transactions in Spain may be freely agreed by the parties. Thus, currencies other than the Euro are valid. In this regard, article 1,170 of the Spanish Civil Code states that in order to validly extinguish an obligation due and payable, any legal currency in Spain shall be accepted.

In an enforcement scenario, judgment debts denominated in foreign currencies (i.e., other than the Euro) are enforceable in Spain, according to article 577 of the Spanish Law on Civil Procedure.

6 Taxation

6.1 Are derivatives transactions taxed as income or capital in your jurisdiction? Does your answer depend on the asset class?

In general terms, for Spanish tax-resident individuals, income deriving from derivatives transactions not connected to a business or professional activity qualifies as a capital gain and is subject to Personal Income Tax at the progressive tax rates for saving income (ranging from 19% to 26%). However, for Spanish tax-resident individuals, if the derivatives transaction is related to a business or professional activity, any income derived qualifies as business and professional income and is subject to Personal Income Tax at a general progressive tax rate (ranging from 19% to 54%). In both cases, no withholding tax would be applicable, as a general rule.

For Spanish tax-resident entities or permanent establishments in Spain of non-resident entities, income arising from derivatives transactions generally qualifies as a taxable profit, subject to Corporate Income Tax or Non-Resident Income Tax (respectively) at a tax rate of 25%. No withholding tax would be applicable in either case.

In case of non-resident taxpayers acting without a Spanish permanent establishment, income deriving from derivatives transactions qualifies as a capital gain and is subject to Non-Resident Income Tax at a tax rate of 19% (and no withholding tax would be applicable) unless a tax treaty prevents Spain from taxing such capital gain. However, according to Spanish domestic law, if the non-resident taxpayer is an EU/EEA tax resident, the capital gain would be exempt from Non-Resident Income Tax.

6.2 Would part of any payment in respect of derivatives transactions be subject to withholding taxes in your jurisdiction? Does your answer depend on the asset class? If so, what are the typical methods for reducing or limiting exposure to withholding taxes?

See our answers above on withholding taxes and domestic exemptions.

6.3 Are there any relevant taxation exclusions or exceptions for certain classes of derivatives?

This is not applicable.

7 Bespoke Jurisdictional Matters

7.1 Are there any material considerations that should be considered by market participants wishing to enter into derivatives transactions in your jurisdiction? Please include any cross-border issues that apply when posting or receiving collateral with foreign counterparties (e.g. restrictions on foreign currencies) or restrictions on transferability (e.g. assignment and novation, including notice mechanics, timings, etc.).

Contracting of financial derivatives is strongly regulated, especially in the sense of ensuring that the contracting parties have all the necessary information to analyse the risk that a transaction may imply. Therefore, derivatives providers must provide to the other contracting party of a derivative (i) all the necessary information to comply with transparency and investor protection requirements, (ii) preliminary information prior to entering into the transaction, including a detailed description of the risks implicit in the financial instrument to be contracted, and (iii) objective valuation methods.

This is especially relevant when one of the parties involved is considered (or may be considered) a consumer. In this case, Spanish courts have been particularly careful when analysing clauses that may be qualified as "abusive"; that is, in general terms, when (i) a clause creates a significant imbalance in the rights and obligations of the contracting parties (resulting in one of them being harmed), and (ii) the provisions of the relevant agreement are not individually negotiated (i.e., they are predisposed by one of the parties). In this respect, Spanish courts are declaring such clauses within derivatives agreements abusive, and therefore null and void.

Other considerations include:

- **Restrictions on posting or receiving collateral with foreign counterparties**: In general, under European and Spanish perspective law, there are no restrictions that apply when posting or receiving collateral between foreign counterparties. The delivery and acceptance of collateral denominated in other currencies is not restricted or conditioned.

  Notwithstanding the above, receiving or posting collateral in the context of transactions with non-Spanish entities may entail other cross-border issues to be considered, such as conflict of laws, tax implications and cross-border insolvency matters.
- **Restrictions on transferability**: Parties may freely transfer the credit rights arising from a derivatives transaction to third parties. However, generally speaking, the consent of the remaining party will be required in case the contractual position under a derivatives transaction is intended (unless otherwise agreed by the parties in the relevant agreement).

  To this end, ISDA has produced a standard form of novation agreement that enables the original parties to close out the existing transaction and conduct the transfer to the transferee of all the rights, liabilities, duties and obligations of the transferor under the original transaction.

  On the contrary, no standard form has been published regulating the transfer of a contractual position in derivatives transactions formalised under the CMOF. In such cases, parties usually subscribe assignment or novation agreements bilaterally negotiated.

8 Market Trends

8.1 What has been the most significant change(s), if any, to the way in which derivatives are transacted and/or documented in recent years?

The implementation of certain European regulation has impacted the documentation produced to formalise derivatives transactions in order to foresee the various requirements and provisions introduced by such regulation (e.g., collateral requirements according to EMIR, provisions on recovery and resolution of credit institutions and the recognition of bail-in, and provisions to foresee an eventual change or cessation of applicable benchmarks).

The foregoing have yielded a number of protocols published by ISDA (e.g., the ISDA 2020 IBOR Fallbacks Protocol, the ISDA 2018 Benchmarks Supplement Protocol and the ISDA 2018 U.S. Resolution Stay Protocol) and, in the case of the CMOF, the publication in 2020 of an updated version of this standard form (basically, with the aim to prevent the cessation of the EONIA benchmark as well as to capture the provisions of the EU Benchmark Regulation. In this regard, please refer to question 3.2 above.

On a separate note, and particularly with regard to interest rate hedging derivatives linked to an underlying loan transaction (financing, refinancing or debt restructuring), in recent years it has become extended market practice to subscribe – prior to contracting the relevant derivative instrument – a hedging letter. The purpose of said hedging letter is to:

(i) provide transparency in the process of contracting the derivative instrument, particularly detailing how the price will be determined; and

(ii) set out the main terms on which the borrower may hedge the interest rate risk (the nominal amount of the loan to be hedged, for how long the instrument will last, if there is a strike or a determined spread, etc.).

8.2 What, if any, ongoing or upcoming legal, commercial or technological developments do you see as having the greatest impact on the market for derivatives transactions in your jurisdiction? For example, developments that might have an impact on commercial terms, the volume of trades and/or the main types of products traded, smart contracts or other technological solutions.

As outlined in question 8.1, recent changes in the regulatory framework have resulted in several amendments to the ISDA and CMOF agreements in place. As per the ISDA agreements, the contracting parties have had to adhere to the relevant ISDA protocol or, in certain cases, a contractual modification itself has been conducted (particularly in order to envisage the contractual recognition of the bail-in provisions according to article 55 of the BRRD). With regard to the CMOF standard, the novation of existing agreements to incorporate the terms of the new applicable regulation has been generally formalised by virtue of the subscription of annexes.

Additionally, the impact of Brexit has also been noticeable from the practical/operational perspective of companies and corporations, since certain hedging providers have relocated their derivatives business to other EU Member States, migrating the ongoing transactions to a different entity of the group (e.g., to a subsidiary incorporated under the laws of Ireland or France). This has meant that various ISDA agreements have been amended to foresee a different entity as the hedging provider and/or a different applicable law and jurisdiction.

Tania Esteban is a Senior Associate in finance with extensive experience in derivatives transactions, Spanish and pan-European securitisation transactions involving all types of assets (ranging from invoices and credit cards to promissory notes and home mortgage loans), and issuances of debt instruments (including high-yield and corporate bonds, and internationalisation covered bonds). Before joining Cuatrecasas, she worked for the legal departments of Bolsas y Mercados Españoles (a company handling organisational aspects of Spanish stock exchanges and financial markets), and Santander Global Banking and Finance, advising on derivative financial instruments.

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Arnau has participated in the implementation of pan-European factoring programmes of receivables from a seller and purchaser perspective. He has also been involved in numerous national and international financing transactions, as well as debt restructuring and refinancing processes.

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