ISDA Publishes China Netting Opinion as FDL Comes into Effect

NEW YORK, August 1, 2022 – The International Swaps and Derivatives Association, Inc. (ISDA) has today published a new legal opinion that recognizes the enforceability of close-out netting under Chinese law. The netting opinion coincides with the entry into force of the Futures and Derivatives Law (FDL), which establishes a statutory framework for the trading of futures and derivatives in China.

ISDA has consistently advocated for enforceable close-out netting as an indispensable pre-requisite for safe and efficient derivatives markets and has published netting opinions for more than 80 jurisdictions around the world. By allowing counterparties to reduce their obligations to a single net payment due from one party to another, netting significantly reduces credit risk. As of the end of 2021, the global gross market value of derivatives contracts stood at $12.4 trillion, whereas the gross credit exposure, which adjusts gross market values for legally enforceable bilateral netting agreements, amounted to $2.5 trillion, according to data from the Bank for International Settlements (BIS).

“We are very pleased these legal reforms in China include the important step of recognizing close-out netting. The publication of the netting opinion, which coincides with the FDL coming into effect, marks a historic milestone in the development of a well-functioning derivatives market in China. Having a netting opinion ready from August 1 will give firms the certainty they need to trade derivatives with Chinese counterparties, enabling effective risk management and supporting economic growth,” said Scott O’Malia, ISDA’s Chief Executive.

The first iteration of the FDL was published for consultation in April 2021, with provisions recognizing netting enforceability and confirming that close-out netting should not be stayed, invalidated or revoked because a party has entered bankruptcy proceedings. After the law was passed in April 2022, ISDA commissioned law firm King & Wood Mallesons to draft the netting opinion to coincide with the implementation of the FDL.

“Having a netting opinion available gives firms a high degree of legal certainty that netting is enforceable, giving them comfort to trade with Chinese firms, which in turn should encourage more participants and increase liquidity. Managing credit risk on a net basis leads to significant efficiencies, which will mean more credit is available for firms looking to raise finance or hedge their exposures,” said Katherine Tew Darras, ISDA’s General Counsel.

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While China is the world’s second largest economy, its derivatives market represents only around 1% of global derivatives market turnover, according to BIS data. With netting now in place, further policy measures will be needed to continue to develop and grow the onshore derivatives market. ISDA set out a series of policy recommendations in a whitepaper in December 2021, covering risk governance, market structure, counterparty and market risk management, and the regulatory framework.

The ISDA netting opinion is available here.

About ISDA
Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 990 member institutions from 78 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association’s website: www.isda.org. Follow us on Twitter, LinkedIn, Facebook and YouTube.

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