

July 15, 2013

FSLRC Cell
Department of Economic Affairs
Ministry of Finance
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Dear Sir

Report of the Financial Sector Legislative Reforms Commission

1. **Introduction:** The International Swaps and Derivatives Association, Inc. (“ISDA”)¹ is writing to you on one aspect of the Report (the “**Report**”) of the Financial Sector Legislative Reforms Commission (the “**FSLRC**”). We note that the Report is in two parts. Volume I deals with recommendations of the FSRLC whereas Volume II sets out the draft law, being the Indian Financial Code (“**Draft Code**”).
2. **Section 182 of the Draft Code:** ISDA and its members would like to seek clarification on Section 182 in Part VI of the Draft Code which provides:

“182. (1) Derivative contracts traded over the exchange and non-exchange traded derivative contracts between sophisticated counterparties are not void notwithstanding anything contained in section 30 of the Indian Contract Act, 1872 (9 of 1872).

(2) Under this section, “sophisticated counterparties” means any person other than a retail consumer under this Act.”
3. We also note the following definitions of “retail consumer” and “eligible enterprise” set out under Section 2 of the Draft Code:

¹ ISDA’s mission is to foster safe and efficient derivatives markets to facilitate effective risk management for all users of derivatives products. ISDA has more than 800 members from 58 countries on six continents. These members include a broad range of OTC derivatives market participants: global, international and regional banks, asset managers, energy and commodities firms, government and supranational entities, insurers and diversified financial institutions, corporations, law firms, exchanges, clearinghouses and other service providers. For more information, visit www.isda.org.

“retail consumer” means a consumer who is an individual or an eligible enterprise where the value of the financial product or of the financial services rendered, does not exceed such amount as may be specified.”

“eligible enterprise” means a person, other than an individual, which at the relevant time has a net asset value of not more than a specified amount or has a turnover of not more than a specified amount, but excludes a financial service provider who is a consumer of a financial product or financial service that is identical to, or substantially similar to, the financial product or financial service that such person provides.”

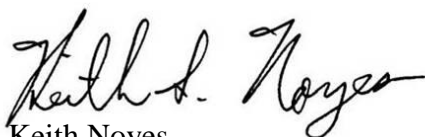
4. **Background:** Under Section 30 of the Indian Contract Act, 1872 (“**Section 30**”), wagering agreements are void. The Reserve Bank of India (Amendment) Act, 2006 (the “**RBI Amendment Act**”) however sought to clarify the validity and legality of derivative transactions in India. Section 45V of the RBI Amendment Act provides that notwithstanding any other law in force, transactions in derivatives specified by the Reserve Bank of India (“**RBI**”) shall be valid provided that one party to the transaction is a Specified Entity, being the RBI, a scheduled bank, or any other entity which falls within the regulatory purview of the RBI under the Reserve Bank of India Act (“**RBI Act**”), the Banking Regulation Act, 1949, the Foreign Exchange Management Act, 1999, or any other act or instrument having the force of law, as may be specified by the RBI from time to time.
5. In its update netting opinion dated November 1, 2006 addressed to ISDA for the benefit of its members and which considered the issues of enforceability under Indian law of the termination, bilateral close-out netting and multi-branch netting provisions under the 1992 and 2002 ISDA Master Agreements, Juris Corp had opined that after the coming into force of the RBI Amendment Act, Validated Transactions (as explained below) would be valid and lawful notwithstanding anything contained in any other law in India currently in force.
6. Validated Transactions, being transactions meeting the criteria set out below, would be valid and would fall outside the purview of Section 30 and to the extent described in the update netting opinion, also fall outside the purview of gaming and gambling laws in various Indian states:
 - (a) At least one of the parties to the transaction should be a Specified Entity (as explained in paragraph 4 above); and
 - (b) The transaction should be in such derivatives as specified by the RBI.
7. The RBI Amendment Act is also worded so that it would cover transactions entered into prior to the RBI Amendment Act coming into effect.

8. The RBI Amendment Act was welcomed by market participants as it provided certainty as to the enforceability of Validated Transactions and had a positive effect on the development and growth of the Indian over-the-counter (“OTC”) derivatives market. OTC derivatives play an important role in the Indian financial markets, including enabling hedging of their business risks by Indian real economy companies. The RBI in specifying the permitted OTC derivatives also sets out the conditions under which they are permitted.
9. **Clarification sought:** Section 182 of the Draft Code provides a safe harbor from Section 30 for derivative contracts entered into between sophisticated counterparties. However, the definition of “retail consumer” (as set out in paragraph 3 above) would include corporates below a prescribed net asset value or turnover, unless the value of the derivative contract exceeds a prescribed amount. The Draft Code is silent on the basis upon which the relevant amounts will be prescribed. It is also unclear how the “value” of the derivative contract is to be determined for this purpose. Our members have no issue with Section 182 of the Draft Code if it is intended that it will provide an **additional** safe harbor to that provided by the RBI Amendment Act. However, we note that the RBI Act is listed in Schedule 6 of the Draft Code and that Section 450 of the Draft Code provides that the Central Government may notify the repeal of the legislations listed in Schedule 6 in whole or in part from time to time.
10. We seek your clarification as to whether the safe harbor provided under Section 182 of the Draft Code is intended to replace or modify the safe harbor provided by the RBI Amendment Act. If it is, our members would wish to make further detailed submissions on the drafting of Section 182 and the related definitions.

We would be most pleased to assist in any way. Please contact Jacqueline Low (jlow@isda.org, at +65 6538 3879) or Keith Noyes (knoyes@isda.org, at +852 2200 5909) at your convenience.

Yours faithfully,

For the International Swaps and Derivatives Association, Inc.



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