

13 December 2019

Scott Farrell
Partner
scott.farrell@au.kwm.com

Heidi Machin
Special Counsel
heidi.machin@au.kwm.com

Max Allan
Senior Associate
max.allan@au.kwm.com

To Australian Financial Markets Association
Level 25 Angel Place
123 Pitt Street
Sydney NSW 2000
Attention: David Love
By email: dlove@afma.com.au

GMRAs governed by Australian law and AFMA Annexes

CONTENTS

Part A Introduction and summary	2
1 Introduction	2
Part B Netting opinion	3
1 <i>Close-out netting contract</i>	3
2 Close-out netting on the <i>external administration</i> of an Australian Party and the insolvency regime applicable to an Australian Party	4
3 Close-out netting under a <i>close-out netting contract</i> governed by Australian law	5
4 RBA	6
Part C Other opinions	6
1 Effect of AFMA Annexes	6
2 Insolvency Proceedings	6
3 Choice of law and foreign jurisdictions	7
4 Assumptions and qualifications	7
5 Benefit	7

Part A Introduction and summary

1 Introduction

1.1 Instructions

We refer to our legal opinion to the International Capital Market Association dated as of 31st March 2019 (“**ICMA Opinion**”) in respect of, amongst other things, the enforceability of close-out netting against an Australian Party under the GMRA (each as defined in paragraphs 1.1 and 1.6 of the ICMA Opinion).

You have asked us to consider whether our conclusions in the ICMA Opinion with respect to a GMRA with an Australian Party, including the Reserve Bank of Australia (“**RBA**”), would apply where the GMRA is governed by Australian law, including where it incorporates the relevant AFMA Annex (as defined in paragraph 1.4 below).

We also refer in this memorandum to our memorandum dated 13 December 2019 entitled “Close-out netting: Summary of Australian Netting Legislation and Insolvency Proceedings” (“**Netting Summary**”), which summarises the relevant sections of the *Netting Act*.

This memorandum supersedes and replaces the version dated 23 August 2018.

1.2 Scope

In this memorandum, we advise on the laws of New South Wales, Victoria, Queensland, Western Australia, the Australian Capital Territory and the Commonwealth of Australia (each, an “**Australian Jurisdiction**”). This memorandum relates only to the laws of the Australian Jurisdictions and is given on the basis that it will be construed in accordance with the laws of New South Wales. We express no opinion about the laws of any jurisdiction other than the Australian Jurisdictions, commercial, accounting, financial, prudential or factual matters. However, the *Netting Act* and other statutes mentioned in the ICMA Opinion are Acts of the Commonwealth Parliament applying throughout Australia.

Each part of this memorandum is subject to the rest of this memorandum, including the assumptions and qualifications.

1.3 Summary of conclusions

(a) GMRA

The conclusions in our ICMA Opinion relating to the enforceability of the Netting Provisions (as defined in paragraph 1 of Part B below) of the GMRA on the *external administration* of an Australian Party would apply where the GMRA is governed by Australian law, including where it incorporates the relevant AFMA Annex. Those conclusions rely on section 14(2) of the *Netting Act*, which applies subject to the specified stay provisions and provided that neither section 14(4) nor section 14(5) of the *Netting Act* applies. The application of section 14(2) of the *Netting Act* to a GMRA that is governed by Australian law, including where it incorporates the relevant AFMA Annex, is described in paragraph 2 of Part B of this memorandum.

In addition, prior to the *external administration* of the Australian Party, section 14(1) of the *Netting Act* is available to validate close-out netting against an Australian Party where the GMRA is governed by Australian law. Section 14(1) of the *Netting Act* also applies subject to the specified stay provisions and provided that neither section 14(4) nor section 14(5) of the *Netting Act* applies. The application of

section 14(1) of the *Netting Act* to a GMRA that is governed by Australian law, including where it incorporates the relevant AFMA Annex, is described in paragraph 3 of Part B of this memorandum.

(b) **RBA**

We confirm that our conclusions in this memorandum relating to the enforceability of close-out netting against an Australian Party under a GMRA governed by Australian law would apply where the Australian Party is the RBA, subject to our comments in Part E of our Netting Summary relating to the enforceability of close-out netting against the RBA.

1.4 Definitions

Capitalised terms used but not defined in this memorandum have the meaning given to them in the ICMA Opinion, as the context requires, and italicised terms used but not defined in this memorandum have the meaning given in our Netting Summary, except where the context requires otherwise.

We also refer in this memorandum to the following Annexes to the GMRA:

- (a) AFMA Annex 1 to the 2011 GMRA ("**2011 AFMA Annex 1**");
- (b) AFMA Annex 1 to the 2000 GMRA ("**2000 AFMA Annex 1**"); and
- (c) AFMA Annex 1 to the 1995 GMRA ("**1995 AFMA Annex 1**") and, together with the 2011 AFMA Annex 1 and the 2000 AFMA Annex 1, the "**AFMA Annexes**".¹

Part B Netting opinion

In this Part B we refer to the *Payment Systems and Netting Act 1998* (Cth) ("**Netting Act**"). The relevant sections of the *Netting Act* are summarised in our Netting Summary.

1 Close-out netting contract

As noted in Part III of Appendix 1 of our ICMA Opinion, the central provisions of each GMRA which provide for close-out netting following an Event of Default are in paragraph 10 (Events of Default), and in particular:

- (a) sub-paragraphs 10(b) to 10(c) of the GMRA 1995;
- (b) sub-paragraphs 10(aA) to 10(cB) of the GMRA 1995, as amended by the GMRA 2011 Protocol;
- (c) sub-paragraphs 10(b) to 10(e) of the GMRA 2000;
- (d) sub-paragraphs 10(aA) to 10(e) of the GMRA 2000, as amended by the GMRA 2011 Protocol; and
- (e) sub-paragraphs 10(b) to 10(f) of the GMRA 2011, excluding the Cross-Agreement Set-Off Provisions,

(such provisions, the "**Netting Provisions**").

The definition of "close-out netting contract" in the *Netting Act* is considered in paragraph 1.1 of Part B of our Netting Summary.

¹ We assume that each of the AFMA Annexes is in the form available in the AFMA Guide to Australian OTC Transactions.

We conclude in our ICMA Opinion that, in our view, each GMRA is a “close-out netting contract” for the purposes of the *Netting Act*. This is because the Netting Provisions contain the elements necessary for the GMRA to be a “close-out netting contract” under the *Netting Act*, as discussed in Part III of Appendix 1 to our ICMA Opinion.² In our view, this conclusion applies equally where the GMRA is governed by Australian law, including where it incorporates the relevant AFMA Annex.

2 Close-out netting on the *external administration* of an Australian Party and the insolvency regime applicable to an Australian Party

We confirm that the conclusions in our ICMA Opinion relating to the enforceability of the Netting Provisions of each GMRA on the *external administration* of an Australian Party would apply where the GMRA is governed by Australian law, including where it incorporates the relevant AFMA Annex.

Section 14(2) of the *Netting Act*, which deals with the protection of close-out netting rights in circumstances where a person who is, or has been, a party to a *close-out netting contract* goes into *external administration*, is considered in detail in Part B of our Netting Summary. As noted in paragraph 1.11 of Part B of the Netting Summary, section 14(2) applies only if either:

- Australian law governs the *close-out netting contract*; or
- Australian law governs the *external administration*.

We assume for the purposes of this memorandum that the GMRA is governed by Australian law. We note that each AFMA Annex provides for the GMRA to be governed by the law in force in New South Wales.³

As considered in paragraph 1 of Part C of our Netting Summary,⁴ the Insolvency Proceedings to which an Australian Party may be subject under *Australian law* fall within the definition of “external administration” in the *Netting Act*.

Section 14(2)(c) of the *Netting Act* provides that, in respect of a *close-out netting contract*, where a party goes into *external administration*:

- (a) obligations under a *close-out netting contract* may be terminated;
- (b) termination values may be calculated; and
- (c) a net amount becomes payable,

in accordance with the *close-out netting contract*.⁵

We note that section 14(2) of the *Netting Act* applies subject to:

- (i) any specified stay provision which is applicable to the GMRA, as considered in paragraph 1.8 of Part B of our Netting Summary;⁶ and

² See paragraph 14 of Appendix 1 of our ICMA Opinion in particular.

³ Item 2(k) of the 2011 AFMA Annex 1, item 2(m) of the 2000 AFMA Annex 1 and item 2(m) of the 1995 AFMA Annex 1 provide that the relevant GMRA is governed by the law in force in New South Wales.

⁴ This is also considered in paragraph 3.6 of our ICMA Opinion.

⁵ The effect of section 14(2), including 14(2)(d) to (g), is considered further in paragraph 1.3 of Part B of our Netting Summary. Please also refer to paragraphs 32 to 34 of Appendix 1 of the ICMA Opinion in relation to section 14(2)(d), paragraphs 53 to 57 of Appendix 1 of the ICMA Opinion in relation to section 14(2)(e) and paragraph 13 of Appendix 1 of the ICMA Opinion in relation to section 14(2)(g).

- (ii) sections 14(4) and 14(5) of the *Netting Act*, as considered in paragraphs 1.4 and 1.5 of Part B of our Netting Summary.⁷

3 Close-out netting under a *close-out netting contract* governed by Australian law

Section 14(1) of the *Netting Act* contains an alternative statutory validation of close-out netting rights which is not dependent on a party to the contract being in *external administration*. In other words, if section 14(2) cannot apply because there is no *external administration*, then section 14(1) may still apply to validate the Netting Provisions provided its conditions are met.

The effect of section 14(1)(c) of the *Netting Act* is that, in respect of a *close-out netting contract*:

- obligations under a *close-out netting contract* may be terminated;
- termination values may be calculated; and
- a net amount become payable,

in accordance with the *close-out netting contract*.⁸

The requirements of section 14(1) of the *Netting Act* may be summarised for present purposes as follows:

- (a) Australian law must govern the GMRA. As noted in paragraph 2 of Part B above, we assume for the purposes of this memorandum that the GMRA is governed by Australian law;⁹
- (b) the GMRA must be entered into in circumstances that are within “Commonwealth constitutional reach” (as defined in the *Netting Act*). Please see paragraph 1.10 of Part B of our Netting Summary with respect to the circumstances which satisfy the requirement for a *close-out netting contract* being within Commonwealth constitutional reach. In summary, these include that a “constitutional corporation” (as defined in the *Netting Act*) is a party to the contract;¹⁰ and
- (c) the GMRA must be a “*close-out netting contract*”. As considered in paragraph 2 above, we consider that each GMRA is a *close-out netting contract* for the purposes of the *Netting Act*.

Sections 14(1)(d) and (e) of the *Netting Act* are intended to clarify that netting will not be affected by the interests of third parties in the obligations being netted.¹¹

Section 14(3) of the *Netting Act* provides that, relevantly, section 14(1) of the *Netting Act* applies subject to:

- (i) any specified stay provision which is applicable to the GMRA, as considered in paragraph 1.8 of Part B of our Netting Summary;¹² and

⁶ Please also refer to Schedule 1 and paragraphs 45 to 52 of Appendix 1 to the ICMA Opinion.

⁷ Sections 14(4) and 14(5) of the *Netting Act* are also considered in paragraphs 26 to 31 of Appendix 1 of our ICMA Opinion.

⁸ The effect of section 14(1) of the *Netting Act*, including section 14(1)(d) to (e), is considered further in paragraph 1.2 of Part B of our Netting Summary.

⁹ Please see footnote 3 above.

¹⁰ A constitutional corporation is defined as a “foreign corporation” or a “trading or financial corporation formed within the limits of the Commonwealth”.

¹¹ Sections 14(1)(d) to (e) of the *Netting Act* are considered further in paragraph 1.2 of Part B of our Netting Summary.

- (ii) sections 14(4) or 14(5) of the *Netting Act*, as considered in paragraphs 1.4 and 1.5 of Part B of our Netting Summary.¹³

4 RBA

We confirm that our conclusions in this memorandum relating to the enforceability of close-out netting against an Australian Party under a GMRA governed by Australian law would apply where the Australian Party is the RBA, subject to our comments in Part E of our Netting Summary relating to the enforceability of close-out netting against the RBA.

Part C Other opinions

1 Effect of AFMA Annexes

Subject to Part B above and paragraphs 2 and 3 below, we confirm that none of the provisions of the AFMA Annexes adversely affects or detracts from our conclusions in our ICMA Opinion. However, as noted below, this memorandum does not deal with the general enforceability of the GMRA.¹⁴

2 Insolvency Proceedings

We refer to paragraph 3.1 (Insolvency proceedings and external administration) of our ICMA Opinion which confirms that, subject to the following, all of the proceedings to which an Australian Party that is registered or taken to be registered as a company under the *Corporations Act* may be subject should be adequately covered by the definition of Act of Insolvency in the GMRA. Those insolvency proceedings are summarised in paragraph 1.3 of Part C of, and paragraph 1 of Schedule 1 to, our Netting Summary and paragraph 3.1 of the ICMA Opinion. The following proceedings would only trigger an Act of Insolvency where the relevant assets or part of the business are a “material part of” the property of that party for the purposes of the definition of Act of Insolvency in the GMRA:

- (a) *appointment of a statutory manager* in respect of the Australian business assets and liabilities of a foreign *ADI*, foreign general insurer or eligible foreign life insurance company;
- (b) *appointment of a judicial manager* in respect of part of the business of a *life company* or an eligible foreign life insurance company; and
- (c) the appointment of a receiver to realise secured assets of an Australian Party.

We note that the definition of “Act of Insolvency” in the GMRA is amended by item 2(a) of each AFMA Annex to include a reference to “equivalent Australian legislation”. We confirm that the inclusion of this reference does not affect our conclusion in paragraph 3.2 of our ICMA Opinion.

¹² Please see footnote 6 above. We note that the references in the paragraphs referred to in footnote 6 are equally applicable to section 14(1) of the *Netting Act*.

¹³ Please see footnote 7 above. We note that the references in the paragraphs referred to in footnote 7 are equally applicable to section 14(1) of the *Netting Act*.

¹⁴ Accordingly, we do not comment in this memorandum on our conclusions in paragraph 1 of Appendix 1 of our ICMA Opinion with respect to the validity of the GMRA.

3 Choice of law and foreign jurisdictions

Each AFMA Annex provides that the GMRA is governed by the law in force in New South Wales and each party irrevocably and unconditionally submits to the non-exclusive jurisdiction of the courts of New South Wales and courts of appeal from them.¹⁵

Subject to the following, the courts of New South Wales and the federal courts of Australia will give effect to the choice of the laws and submission to jurisdiction of certain courts referred to immediately above, unless to do so would be contrary to public policy in the Australian Jurisdictions.

We express no opinion as to whether a court will give effect to a choice of laws to govern the GMRA to the extent that the choice of laws applies to non-contractual obligations arising out of, or in connection with, the GMRA (including, without limitation, non-contractual obligations within the meaning of Regulation No 864/2007 of the European Parliament and of the Council of 11 July 2007 on the law applicable to non-contractual obligations (known as “Rome II”).

4 Assumptions and qualifications

This memorandum should be read in conjunction with our ICMA Opinion¹⁶ and our Netting Summary and is subject to the assumptions and qualifications set out in our ICMA Opinion and our Netting Summary. This memorandum does not purport to update our ICMA Opinion or our Netting Summary, including to the extent it brings down the conclusions in our ICMA Opinion, and our opinions in our Netting Summary on the application of our ICMA Opinion are given as of the date of the Netting Summary.

This memorandum does not purport to be an analysis of all issues which could arise in entering the GMRA. For example, it does not deal with matters related to power and authority, use of power for a property purpose, general enforceability of contracts or corporate authorisations.

For the purposes of this memorandum, we also assume that any *external administration* of a party to the GMRA commences after 1 June 2016.

This memorandum is strictly limited to the matters stated in it and does not apply by implication to other matters.

5 Benefit

This memorandum is addressed to you personally and may not, without our prior written consent, be:

- (a) relied on by another person;
- (b) disclosed, except to members of AFMA, subscribers to the AFMA Guide to Australian OTC Transactions and persons who in the ordinary course of your or their business have access to your or their papers and records. Such disclosure is only made on the basis that such persons will make no further disclosure; or
- (c) filed with a government or other agency or quoted or referred to in a public document.

¹⁵ Please see footnote 3 above.

¹⁶ As if references to English law were to Australian law, where appropriate.

This memorandum is given in respect of the laws of the Australian Jurisdictions which are in force at 9.00am local time on the date of this memorandum and we are not obliged to update it.

Yours faithfully

A stylized, handwritten signature in black ink. The signature consists of the letters 'K' and 'W' joined together, with a large, sweeping flourish underneath that extends to the right and then curves back down.