

# KEY THINGS TO KNOW

## ABOUT DERIVATIVES IN UZBEKISTAN



This paper will focus on the key aspects of the regulation of cross-border cash-settled derivative transactions entered into with an Uzbekistan-incorporated counterparty outside the exchange trading platform.

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## **1** What does Uzbek law say about derivatives?

Derivative transactions are not governed by Uzbek law as a separate class of specific commercial transactions.

Any cash-settled derivative transactions fall within the regulation of currency law as a transaction associated with an inbound / outbound flow of foreign currency proceeds.

This implies that an Uzbek counterparty participating in a cross-border derivative transaction should comply with Uzbekistan's foreign exchange control.

For a non-Uzbek counterparty, the major implications of this could be that (i) the derivative transaction may trigger certain registration requirements that must be met in order to make it enforceable against the Uzbek counterparty; and (ii) a withholding tax payable at the source in Uzbekistan may arise as a result of income received under the derivative transaction.

## **2** Who might my counterparty in Uzbekistan be?

Uzbek currency laws allow Uzbekistan-licensed banks to enter freely into cash-settled derivative transactions within the limits of their foreign currency exposure.

The Central Bank of Uzbekistan (CBU) is a "Frankenstein-type" hybrid institution. CBU participates in derivative transactions to the extent that they are compatible with its function as a national reserves manager (including of gold bars and foreign currency).

Quasi-bank institutions (microcredit, microfinance and credit union institutions, investment and pension funds, insurance companies) are not holders of a banking license and therefore are not covered by the above provision relating to ordinary operational banks.

Companies and other non-financial institutions can enter into hedging transactions to hedge their risks involved in the underlying loan agreements. Other types of derivative transactions are problematic due to the limitations of foreign currency laws.

### 3 Can I use the ISDA Master Agreement?

A good market practice established in Uzbekistan is using an ISDA Master Agreement as an umbrella agreement governing cross-border derivative transactions.

Modifications to the ISDA Master Agreement template are required to meet certain provisions of Uzbek laws. Such modifications are reflected in the schedule of the ISDA Master Agreement and may vary depending on the nature of the Uzbek counterparty. The most common amendments include adding certain tax details of the Uzbek counterparty, adding a list of the documents that need to be delivered by the non-Uzbek counterparty for claiming a reduction in withholding tax in Uzbekistan, and updating the definition of “Bankruptcy” to comply with Uzbek law.

### 4 Can I trust verbal agreements?

Uzbek legislation does not recognise verbal agreements in cross-border deals and provides that a transaction with the participation of at least one non-Uzbek counterparty must be made in writing in order to be enforceable. The provisions in the ISDA Master Agreement regarding verbal agreements will not necessarily entail a binding obligation upon the Uzbek counterparty.

Avoiding any verbal agreements with Uzbek counterparties is therefore highly recommended.

### 5 Will a completed “confirmation” of a transaction be sufficient?

The form of the “confirmation” of a transaction (such as SWIFT or similar confirmations) needs certain modifications in order to comply with Uzbek law. To accommodate the requirement of a “written form”, each document issued in connection with the ISDA Master Agreement must (i) specify the parties thereto or, if there is only one party, an addressee to whom this document is related must be specified; and (ii) reflect the consent to and acknowledgement of the transaction specified therein; if it is a one-party document, an acknowledgement needs to be included so that the other party (an addressee of this document) countersigns it. For signing / countersigning, a physical signature is not required if a digital signature is provided. A SWIFT confirmation, or any other document issued via the Reuters Dealing Machine or another similar service, can be sent online, via email or using another electronic method, and must contain a digital signature in order to comply with the above requirements of Uzbek law.

## 6

### How do set-off and close-out netting work in Uzbekistan?

There is bad news when the Uzbek counterparty goes bust and bankruptcy proceedings against it are initiated. If close-out netting and set-off are not completed before proceedings are started, there are certain risks that may affect their implementation during the bankruptcy proceedings. These risks arise from the mandatory provisions of Uzbek bankruptcy law relating to:

- moratorium
- claw-back period

These risks are rather prominent and will prevent the issuing of a clean legal opinion on the enforceability of close-out netting and set-off provisions under the ISDA Master Agreement.

## 7

### Is cherry-picking possible?

The bad news is that in bankruptcy proceedings an Uzbek liquidator is entitled to “cherry-pick” the obligations of an Uzbek debtor. However, the good news is that when the liquidator is cherry picking, in theory they would not be able to disregard some onerous transactions and accept others while they are all covered by the same single umbrella document, i.e. the ISDA Master Agreement. It should be noted that this approach has not yet been tested in an Uzbek court and it is still not known exactly what logic an Uzbek judge may apply when deliberating such cases.



## Three more things to consider

### Gambling

In accordance with the Uzbek Civil Code, claims in connection to gambling or betting are not enforceable. In Uzbekistan, there is no court history that would provide an interpretation of this provision of the Civil Code and explain whether it may affect the enforceability of derivative transactions. However, there is a good chance that the logic that dominated a couple of decades ago in Russian courts may be applied by an Uzbek judge today. After the 1998 financial crisis in Russia, Russian courts ruled that non-deliverable forwards (NDFs) constituted “gambling” transactions and were unenforceable. Such judicial treatment was applied between 1998 and 2008, at which point that provision of the Russian Civil Code was changed to legitimise NDFs.

### Choice of law

The choice of English law or New York law as the governing law of the ISDA Master Agreement is valid and binding under Uzbek law and should be recognised and given effect in an Uzbek court.

### Choice of forum

In accordance with the laws of Uzbekistan, judgments of foreign courts and arbitrates shall be enforced in Uzbekistan in a manner provided for by the legislation or in accordance with the international treaties to which Uzbekistan is a party. Uzbekistan is not a party to any multilateral or bilateral treaties with any Western jurisdictions or the USA for the mutual enforcement of court judgments. Consequently, if a judgment is obtained from an English or New York court, it is highly unlikely to be given direct effect in Uzbek courts.

A foreign arbitral award shall be recognised in Uzbekistan without re-trial on the merits, as Uzbekistan is a party to the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards. Accordingly, a foreign arbitral award obtained in a state that is a party to the New York Convention should be recognised and enforced by an Uzbek court.

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