How to Improve Master Agreement and Related Trading Agreement Negotiations – A Practitioner's Best Practice Guide

I. Introduction

The Global Documentation Steering Committee ("GDSC") is a group of major, internationally active commercial and investment banks and other institutions that deal in and use financial products available in the over-the-counter markets. The GDSC's mission has been to help create standardized documentation to assist counterparties and the over-the-counter markets in which they participate in avoiding the risks, particularly in market crises, that inconsistent documentation may foster. The primary objective of the GDSC has been to encourage harmonization in standard documentation so that when firms transact in different over-the-counter markets through different agreements, disparities in documentation do not exacerbate market, credit or legal risk.

It has become apparent to the GDSC that the documentation process and, more particularly, the efficient functioning of that process, can also be instrumental in reducing risk. Protracted negotiations may extend the risks attaching to undocumented relationships, delay the development of beneficial trading relationships and waste resources.

Accordingly, the GDSC offers the following guide to "best practices" in negotiating master agreements. The GDSC does so deferentially, recognizing that others, over time, may well have a great deal to contribute to best practices such as these. The GDSC is aware, furthermore, that no set of best practices will be appropriate for all parties and all settings. Certain counterparties, under particular circumstances, may well have excellent reasons for adopting an independent course. Nonetheless, the GDSC firmly believes that the practices set forth below will be helpful in most instances and, if adopted by the over-the-counter markets, will improve the efficiency of the documentation process and reduce risk. Even when parties substantially disagree, a well-organized and streamlined documentation process will facilitate parties recognizing and ultimately resolving their disagreements.

The mission of the GDSC from its inception has been to implement the documentation-related recommendations in the 1999 Report published by the Counterparty Risk Management Policy Group ("CRMPG"), a group of 12 major, internationally active commercial and investment banks formed with the objective of promoting enhanced strong practices in counterparty credit and related risk management after the market disruptions of 1997 and 1998. This Guide is consistent with the related CRMPG recommendations and is intended to forward the CRMPG goals of reducing risk and improving the functioning of markets.

It may be helpful at the outset to articulate the four principles that underlie this Guide:

- Parties to trading agreement negotiations should identify the important issues between them and each involve appropriate decision-making personnel early in the process.
- The parties should set a time frame for the negotiations and stick to it.
- Both internal and external (bilateral) lines of communication must be established and maintained.
- Personnel involved in the negotiations must be committed to advancing the process and overcoming negotiation roadblocks.

Although these general principles have been evolved into the more specific provisions below, they are the consistent themes that GDSC hopes will come to infuse the negotiation process.

A. Purpose of this Guide

The purpose of this Guide is to assemble and present a series of documentation process best practices to assist participants in the over-the-counter markets in organizing and focusing their efforts in putting master agreements and other trading documents into place. This Guide is organized according to the relevant stages in the documentation process and reflects steps each counterparty should take internally, as well as steps to be taken in tandem with each negotiating partner.

The GDSC recognizes that some of the practices in this Guide are not yet routinely observed in the over-the-counter markets. The GDSC is hopeful that this situation will change in the near term. Certainly, a period of adjustment will be necessary before the Guide can be said to articulate what market practice is, as opposed to what the GDSC believes it should be.

B. Negotiation Goals

1. Produce timely executed agreements with risk appropriate content, recognizing that achieving an executed agreement (even if neither party has achieved all of its preferred positions) has an important risk management value. (Parties are urged to maintain a cost/benefit analysis throughout the negotiation to make sure that time and resources are being used wisely.)

2. Enhance business relationships.

II. Best Practices Before Negotiation Begins

A. Internal

1. (a) When negotiating multiple agreements with the same counterparty, identify all the agreements you wish to negotiate so negotiation policies may be coordinated and (b) coordinate the process of documentation

within your firm and between affiliate groups to avoid unnecessary multiple and inconsistent negotiations (recognizing that different product lines and trading entities may have good reasons to require different documentation policies).

2. Identify who will coordinate the negotiation for your firm. Make sure all affected areas within your firm are represented in and support the negotiation. In any event, each firm should focus responsibility in its credit department in a coordinated fashion for all credit decisions with respect to a given counterparty.

3. Confirm which terms are important in the negotiation from your firm's point of view and have an established mechanism for modifying such terms and resolving all negotiating issues on a timely basis that does not delay the progress of negotiation.

4. Ensure that necessary credit terms and instructions are in place in order to commence negotiations.

5. Changes to industry standard documentation should reflect only important legal, business or credit concerns.

6. Ensure that your firm is providing adequately trained and skilled staff to support the negotiation. Consider creating annotated schedules or user's guides for use by your negotiating staff.

7. Open and maintain lines of communication among internal participants in the negotiation process.

B. External

1. Agree as a commercial matter about the type of documentation to be negotiated.

2. Identify the key credit issues (including credit support) and open and maintain lines of communication among participants in the negotiation process.

3. Decide whose draft will be used as the starting point for negotiations.

4. Agree at the outset to a realistic time frame for the negotiation, considering the nature of the counterparties and the agreement to be put in place, which shall be the shortest period agreeable. A maximum of 90 days should be sufficient. Of course, if no trades are imminent, a longer negotiation period may be appropriate. If a substantial business relationship is imminent, a much shorter period may be appropriate.

5. Prioritize negotiations based on the projected time frame for trading, potential credit exposure and other risks, counterparty relationship issues and revenue potential.

III. Best Practices When Negotiations Commence

A. Internal

1. Send out draft documentation as soon as practicable.

2. Have a system for tracking negotiations or a reporting tool that allows you to identify how long each negotiation is outstanding, the party with the current obligation to respond and a list of outstanding issues.

3. Have clear parameters as to when you will require legal opinions from your counterparty and what provisions these opinions should contain. There may be a basis for distinguishing between cases where opinions limited to capacity and authority issues may be appropriate and those where a full enforceability opinion may be appropriate. Such circumstances may include, for example, a counterparty having an unusual organizational or regulatory status, involvement in an unfamiliar jurisdiction or uncertainties with respect to particular transactions. Counterparties should make efforts to use reasonably standard opinion language and concepts.

4. The negotiator should keep relevant personnel in credit, operations and the front office informed of progress in the negotiation, and apprised of any material changes to the terms of the documents and all outstanding issues.

B. External

1. Acknowledge receipt of drafts promptly and respond within ten business days of receipt. If it is not possible to respond to an entire draft within that time frame, respond to the extent possible.

2. Make sure there are direct lines of communication among the individuals responsible for negotiating and approving the final documentation in addition to existing relationship lines of communication.

3. Always have a substantive explanation of the provisions proposed by your firm. The explanations that 1) "It is our policy to do it this way.", 2) "Many other counterparties have agreed to this.", 3) "Trust us - you know we won't use this provision.", 4) "Just don't default and it won't be a problem.", and 5) "We have made more changes in your favor than in ours.", are not sufficient explanations.

4. Mark changes clearly on any document you send to your counterparty and provide explanations where suggested changes have been rejected or deleted.

5. Provide, if requested, information regarding your capacity and authority to enter into the relevant contracts.

6. Do not insist on absolute reciprocity in drafting. If the two parties have different characteristics, some different provisions may be appropriate.

7. Focus on key issues. Some issues arise in almost all negotiations. Others arise primarily in relation to particular types of counterparties. Make sure negotiators understand the limited applicability of specialized provisions.

IV. Best Practices when Negotiations Stall

A. Internal

1. Distinguish clearly between different types of issues (i.e., legal, credit and business) so you know what type of approval is needed for changes.

2. Have a clear process for obtaining approval for negotiated compromises.

3. Escalate contentious issues promptly to relevant senior staff.

B. External

1. Make sure there is a definitive list of significant issues and that each side understands the reasons for the other side's position.

2. Consider whether a meeting or a formal call involving appropriate senior people will help to resolve outstanding issues.

3. If agreement cannot be reached on all points, identify next steps to be taken and agree on a time frame and/or other conditions for proceeding.

V. Best Practices after Negotiations Have Been Completed

A. Internal

1. The party controlling the draft should send execution copies, promptly and in any event within five business days after agreement has been reached.

2. Each party transmitting executed copies to the other party should include in the package all other documents it is required to deliver in connection with the documentation.

B. External

1. After the documentation has been agreed, the recipient of execution drafts of documents should execute the documents and return them within five business days after receipt.