Netting Provisions in Standard Master Netting Agreements

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Effective management of Sales and Trading Risk essential to success and viability of Financial Services Firms
• INITIALLY RISK MANAGEMENT FOCUSED EXCLUSIVELY ON MARKET RISK

• NOW OPERATIONAL RISK OR NON-MARKET RISK RECEIVING INCREASED FOCUS

• OPERATIONAL RISK INCLUDES COUNTERPARTY CREDIT RISK
• LEGAL RISK - A KEY COMPONENT OF COUNTERPARTY CREDIT RISK

• TO UNDERSTAND LEGAL RISK MUST ANALYZE ENFORCEABILITY OF NETTING RIGHTS IN CONTEXT OF COUNTERPARTY INSOLVENCY
USE OF STANDARD AGREEMENT FORMS TO MANAGE COUNTERPARTY RISK ACROSS FINANCIAL PRODUCT TYPES

GOAL - REDUCTION OF SYSTEMIC RISK

ENDORSED BY:

REGULATORS

THE COUNTERPARTY RISK MANAGEMENT POLICY GROUP
INDUSTRY ASSOCIATIONS, INCLUDING:

The Bond Market Association (TBMA)
The British Bankers’ Association (BBA)
The Emerging Markets Traders Association (EMTA)
The Foreign Exchange Committee
The International Swaps and Derivatives Association (ISDA)
The Japan Securities Dealers Association (JSDA)
The London Investment Banking Association (LIBA)
The Investment Dealers Association of Canada (IDA)
TBMA/ISMA GLOBAL MASTER MASTER REPURCHASE AGREEMENT

• Repurchase Transactions

• Buy/Sell Back Transactions
MASTER AGREEMENT

CONFIRMATIONS

ANNEX 1 - SUPPLEMENTAL TERMS AND CONDITIONS - ELECTIONS include:

- Party to send confirmations calls
- Inclusion of Buy/Sell Back Transactions
- Inclusion of Equity Securities, Net Paying Securities
- Base Currency
- Pricing Sources
- Interest Rates payable on Cash Margin
- Delivery period for margin
STRUCTURED AS A SALE

EVENTS OF DEFAULT
• Failure to perform
• Insolvency
• Repudiation
• Breach of representation

NETTING
• Payment/delivery
• Close out
CROSS - PRODUCT MASTER AGREEMENT
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Contractual “superstructure” cross default and netting rights among any number of agreements
PRINCIPAL AGREEMENTS -
Underlying Master Agreements designated from time to time by parties

UNCOVERED TRANSACTIONS -
Transactions not otherwise subject to a master agreement
CLOSE OUT EVENTS

- Permits close out of all transactions under all PRINCIPAL AGREEMENTS
- Overrides notice, cure periods etc. in specific PRINCIPAL AGREEMENTS
- Identification of additional CLOSE OUT EVENTS
- Exclusion of defaults having little relationship to counterparty creditworthiness from definition of CLOSE OUT EVENTS
- Exceptions - transactions that cannot lawfully be closed out
SETTLEMENT AMOUNTS

• Valuation of transactions, netting of obligations, application of collateral etc. pursuant to the terms of relevant Principal Agreements

• Option to net excess collateral

• Settlement amounts translated into single BASE CURRENCY

• SETTLEMENT AMOUNTS set off to reach FINAL NET SETTLEMENT AMOUNT