Conference on Netting of OTC
Financial Contracts in Latin
America and the Caribbean

The Benefits of Netting to Local Financial Institutions, Local End-Users and the Local Economy

Marjorie E. Gross
Senior Vice President &
Associate General Counsel
The Chase Manhattan Bank

Benefits of Having Sound Legal Basis for Enforcement of Master Agreements: Local Financial Institutions

- Reduce counterparty legal risk
  - reduces risk that bankruptcy official (sindico) will be able to “cherry-pick”, i.e. repudiate contracts where counterparty owes money to financial institution but enforce contracts where financial institution owes money to counterparty
  - reduces risk that financial institution will be unable to close out its transactions with an insolvent counterparty due to a “stay”, during which the MTM amount may fluctuate widely and increase the FI’s exposure

- Reduces need to maintain capital on a gross basis
  - e.g. if gross positive mark to market for Counterparty A is $1 billion, but net positive mark to market for Counterparty A is $30 million, then Bank A may save substantial capital charges

Benefits of Netting, continued

- Reduces counterparty credit risk credit
  - will usually allow financial institution to do more business with any one counterparty, since its credit lines are determined on a net basis

Benefits of Having Sound Legal Basis for Enforcement of Master Agreements: Local End User

- Since FI's exposure to it will be calculated on net basis rather than gross basis for credit purposes, FI may be more willing to deal with it

- Since FI's exposure will be calculated on net basis rather than gross basis for capital purpose, FI's cost of doing business with it may be lower, and costs to local end user will be lower

- End Users should want to deal with FI's in jurisdictions with a sound basis for netting, to avoid being the subject of cherry picking if their counterparty becomes insolvent

Benefits of Having Sound Legal Basis for Enforcement of Master Agreements Foreign Financial Institutions

- Same as for local financial institutions
  - lower capital charges
  - lower credit charges per counterparty
  - lower country exposure

Benefits of Having Sound Legal Basis for Enforcement of Master Agreements: The Local Economy

- Foreign financial institutions are more willing to make risk management tools available to local corporations
  - this should increase liquidity, decrease spreads in local market
- Foreign financial institutions are less likely to “pull the plug” at the first sign of financial trouble, since they will be less worried about bankruptcy moratorium and cherry-picking
- Having sound statutory basis makes foreign financial institutions less concerned with potential discrimination in local court systems