

ISDA

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August 10, 2001

Domingo Cavallo
Minister, Ministry of Economy
Buenos Aires, Argentina

Roque Maccarone
President, Central Bank of Argentina
Buenos Aires, Argentina

Daniel Marx
Secretary of Finance, Ministry of Economy
Buenos Aires, Argentina

Carlos Weitz
President, National Securities Commission
Buenos Aires, Argentina

Dear Messrs:

ISDA recognizes the great strides made in Argentina to improve regulatory conditions for over-the-counter (OTC) derivatives transactions. Specifically, I hope to enlist your support for approval by the Chamber of Deputies of legislation amending the Argentine Bankruptcy Law, the Financial Institutions Law and the Charter of the Central Bank of Argentina to permit close-out netting (the "Close Out and Netting Bill"). As the international organization concerned with privately negotiated derivatives transactions, we are following closely the progress to date and will continue to do so with the Argentine Derivatives Association.

We are encouraged by last year's approval of the Close Out and Netting Bill by the Senate that ensures the enforceability under Argentine law of close-out netting for the non-insolvent party that terminates derivatives and repo transactions under master agreements in the event of the insolvency of an Argentine counter-party. In our view, this amendment provides the necessary building blocks for creating a favorable legal framework for OTC derivatives transactions.

Enactment of this legislation would promote legal certainty among international market players with respect to the enforceability of close-out netting in Argentina. In the absence of such legislation, central banks of leading jurisdictions have been unwilling to permit supervised credit institutions in their jurisdictions to net their exposures under OTC derivatives contracts with Argentine counter-parties for capital purposes. This raises the cost of derivatives transactions in Argentina and puts Argentine market participants at a competitive disadvantage. The approval of the Close Out and Netting Bill will allow foreign financial institutions to calculate their exposure with Argentine counter-parties on a net rather than on a gross basis. This will encourage foreign financial institutions to increase their credit lines to Argentine counter-parties. The Close Out and Netting Bill will bring Argentina in line with a number of

jurisdictions around the world where foreign and local institutions benefit equally from netting legislation.

Judging from ISDA's recent discussions with professionals active in the derivatives market in Argentina, there appears to be considerable support for strengthening the enforceability of netting as soon as possible. We are confident that the approval of the Close Out and Netting Bill will further solidify and improve the Argentine economy. Please refer to the enclosed memorandum for additional information and details regarding the benefits of close-out netting.

ISDA is a global organization and its more than 540 members include most of the world's leading participants in OTC swaps and derivatives transactions. The membership of ISDA also includes many of the businesses, financial institutions, governmental entities and other end users that rely on OTC derivatives to manage financial and other risks inherent in their core economic activities with a degree of efficiency and effectiveness that would not otherwise be possible. ISDA's members represent over 41 jurisdictions world-wide and include firms dealing in privately negotiated derivatives transactions in Argentina. A complete list of ISDA's members is attached to this letter as Exhibit A. Additional information with respect to ISDA and its programs is available on the ISDA website at www.isda.org.

If ISDA can be of any assistance in this process, I hope that you will not hesitate to call on me or my colleagues Ruth Ainslie or Pedro D. Martinez at (212) 332-2562 and (212) 332-1207, respectively.



Yours sincerely,
Robert Pickel
Executive Director and Chief Executive Officer

cc: Andres Hall
Director, National Securities Commission
Buenos Aires, Argentina

cc: Eduardo Escasany
President, Argentine Bankers Association
Buenos Aires, Argentina

cc: Eduardo Trucco
President, Argentine Derivatives Association
Buenos Aires, Argentina

August 10, 2001

Memorandum

Benefits of Close Out Netting:

ISDA believes that a sufficient legal framework for derivatives is vital to: 1) creating certainty regarding the legal enforceability of derivatives transactions, 2) providing market participants in Argentina with the ability to use derivatives to manage their risk and 3) attracting more investors to Argentina and ultimately encourage the development of the Argentine derivatives market. In our view, the Close Out and Netting Bill will provide the necessary building blocks for creating a legal framework supporting the enforceability of close-out netting without disturbing principles of equal treatment of creditors under Argentine insolvency law.

Advantages of Netting Legislation

We set forth below some of the arguments in favor of introducing legislation to provide for the enforceability of close-out netting for OTC derivatives transactions:

1. If close-out netting is enforceable, counterparties' credit risk can be safely counted on a *net*, rather than a *gross* basis. Netting can reduce credit exposure by 40 to 60 per cent.
2. Where close-out netting is enforceable under local law, regulators and risk managers can allow banks to make their capital adequacy calculations accordingly, thereby reducing capital costs and increasing credit lines to Argentine counter-parties.
3. Without adequate netting legislation, Argentine banks, as well as any Argentine entities seeking to manage risks by means of OTC derivatives, will face higher costs than their competitors in pro-netting jurisdictions which clearly provide for the enforceability of netting.
4. Netting legislation would bring the legal framework of Argentina closer in line with other countries, who have passed similar legislation and have witness its advantage.
5. Netting legislation would promote legal certainty.

1. Netting Reduces Credit Risk

Close-out netting reduces credit risk by allowing parties to net their exposures under different derivatives transactions against one another. Where close-out netting is uncertain, parties must calculate their credit exposures on a gross, rather than a net basis. If two parties have entered into several different transactions with one another, at any given time some transactions may constitute assets, while others are liabilities. If a party is able to net its liabilities against its assets, its overall credit risk is considerably reduced. Estimates suggest that calculating credit exposure on a net basis can reduce overall credit risk by as much as 40 to 60 per cent. Exhibit B provides a concrete example of how netting reduces credit risk.

This reduction in credit risk can best be achieved when each transaction is entered into as part of a 'single agreement', documented under an adequate master agreement (such as the ISDA Master Agreement), in a legal environment that recognizes the enforceability of close-out netting.

The widespread use of master agreements providing for close-out netting also has all important beneficial effect on systemic risk. Market participants face a considerable exposure to risks stemming from the failure of a major market participant causing cascading insolvencies through counter-parties. The substantial credit risk reduction achieved by close-out netting considerably lessens this consequential effect by reducing counterparty exposure at each node in the network of relationships between market participants and by encouraging best practices by properly documenting trades at the earliest possible time.

2. Netting Reduces Capital Costs

Where credit risk is reduced, banks are able to use their capital more efficiently. Credit lines can be freed up and reserves may be reduced so as to allow a more productive use of capital which would otherwise be allocated inefficiently. Recognizing these advantages the G 10 central banks and central banks of other leading jurisdictions have permitted, subject to prudent conditions, the recognition of close-out netting for capital adequacy and large exposure purposes. Under such conditions, banks find it more efficient to enter into trading relationships with counterparties in jurisdictions where netting is enforceable because any liabilities under such relationships can be calculated on net, rather than a gross, basis. Trading relationships with counter-parties in jurisdictions where netting is not certain require greater allocations of capital, making them more expensive.

3. A Netting Statute Can Help Argentine Banks and Businesses Compete

The growth of financial innovation in OTC derivatives worldwide had allowed corporations, financial institutions, government, individuals and other end users to access a full range of financial instruments to manage their risk. Higher levels of liquidity in the Argentine market should be expected as international and local dealers increase volumes of transactions as demand and sophistication increases. In addition, the need of Argentine entities of having access to hedging tools that can allowed them to better manage their risks are becoming more relevant as global markets are becoming more volatile. The enactment of the new convertibility law, which will link the Argentine peso to the U.S. dollar and euro, may cause an increase in demand of Argentine entities to hedge their currency exposure as the Argentine peso becomes more sensitive to two different currencies in a 50%-50% weighted basket.

Ensuring legal certainty for close out netting would reduce costs for Argentine banks and encourage the growth and competitiveness of the Argentine financial markets. In particular, it will promote the development of a local derivatives market. Because of the uncertainty as to the enforceability of close-out netting with Argentine banks and corporations, central banks of other leading jurisdictions do not allow supervised institutions in their jurisdictions to net against Argentine counter-parties for capital purposes. This makes it more expensive, due to the increased capital cost, for a non-Argentine bank to enter into an OTC derivative transaction with an Argentine bank or corporation.

Not only Argentine banks and corporations, but also Argentine branches of foreign banks, would be at a competitive disadvantage because of such uncertainty. Due to concern that the inclusion of an Argentine branch of a multibranch bank counterparty might “contaminate” close-out netting under the master agreement against that multibranch bank in its home jurisdiction, many counter-parties would require that Argentine branches of their multibranch counter-party be excluded from the scope of a master agreement governing their OTC derivatives transactions. In some cases, this means that the other party will not deal at all with the Argentine branch. In other cases, the other party will deal with an Argentine branch, but only pursuant to a separate master agreement, allocating a separate credit line and allocating capital to such positions on a gross basis. This makes dealing with the Argentine branch of an entity more costly.

The overall result would be that the Argentine banks and corporations in Argentina, would bear additional costs when entering into hedging transactions with foreign counter-parties. The adoption of effective legislation to resolve any uncertainty as to the enforceability of netting with Argentine entities would reduce these costs. An effective netting regime would also produce other benefits for market participants, including more efficient use of credit lines and the ability to maintain lower reserves to cover exposures.

4. Netting legislation would bring the legal framework of Argentina closer in line with other countries, who have passed similar legislation.

The Argentine market is becoming more transparent and competitive as standardized international rules are adopted. The recently enacted competitive law has brought into alignment the current Argentine legal framework with those in force in other jurisdictions and would provide certainty and reliability on the Argentine market.

Recognizing the substantial credit and systemic benefits of close-out netting, many jurisdictions, including several civil code countries have thought it prudent to eliminate doubt about the enforceability of netting by introducing legislation to enable it or, more often, to strengthen it where it was already available. Examples (this is not an exhaustive list please refer to Exhibit C for more information) include, in the European Union, Austria, Belgium, Denmark, Finland, France, Germany, Ireland, Italy, Luxembourg, Portugal, Spain and Sweden and, elsewhere, Australia, Canada, Norway, South Africa, Switzerland and the United States of America. Where it was unclear whether the close-out netting provisions will be enforceable, as is the case in a number of emerging market jurisdictions, ISDA is supporting local initiatives towards netting reform and significant progress has been achieved. For example, Mexico has enacted in May 2000 a new bankruptcy law that ensures the enforceability of close-out netting provisions of a master agreement, such as the ISDA Master Agreement. This year, the Brazilian Congress enacted legislation regulating the activities of clearing houses, which will have an important impact on multilateral netting of exchange-traded transactions. Although the legislation does not extend to providing protection for the enforceability after default of bilateral OTC derivatives transactions, the issuance of recent regulation by the Brazilian Central Bank has shown important steps towards the adoption of close-out netting for OTC derivatives transactions in the near future.

The enactment of the Bill will allow international institutions to be in line with current practices applicable to governmental entities for purposes of close-out netting. Therefore, its approval should not create any specific privilege for either foreign or local financial institutions dealing with OTC derivatives transactions in Argentina. The Close Out and Netting Bill will establish clearly the enforceability of close-out netting and bring Argentina in line with an number of jurisdiction around the world on the issue.

Exhibit C displays the current status of existing and proposed netting legislation in North American, the European Union and Asia together with details of the coverage of the opinions addressing the enforceability of netting under the ISDA Master Agreement that ISDA has obtained from law firms in those jurisdictions.

5. Netting Legislation Would Promote Legal Certainty

It is important to note that, even if existing law is thought to have a similar effect to specific legislation, without clear legislation many parties will effectively be replacing credit risk with legal risk if they rely on uncertain legal foundations for close-out netting. Netting legislation would remove the threat or potential for costly litigation. There will be legal uncertainty regarding the contractual protections provided in the ISDA Master Agreement until the relevant provisions of existing legislation are tested in a court of last resort. Adopting netting legislation would eliminate uncertainty and give clear guidance to the Argentine courts. This would enable parties doing business in Argentina to rely on the contractual protections offered by the ISDA Master Agreement.

Exhibit B

Example of risk reduction via close-out netting

Swaps and other derivative transactions can be said to have a value to one or other of the parties. This value derives from the underlying rate, asset or risk to which the derivative relates. For example, the value of a straightforward fixed-for-floating interest rate swap derives from anticipated market interest rates for the currency concerned. To the fixed rate payer, the swap will have a value if, to replace the swap now, it would have to pay a higher fixed rate (in return for LIBOR) than it is required to pay under the existing swap. The swap would be, in that sense, an asset for the fixed rate payer in these circumstances, and a liability for the floating rate payer. In other words, the fixed rate payer is “in-the-money” and the floating rate payer is “out-of-the-money”.

Over the course of time, a bank may enter into a number of different interest rate swaps with a counterparty. At any point in time, under some of those swaps the bank may be in-the-money, while under others it may be out-of-the-money. If the counterparty were to become insolvent, the bank would attempt to terminate all outstanding swaps with the counterparty. If all those outstanding swap transactions had been documented under an ISDA Master Agreement, then they would have been entered into on the basis that they constituted a single agreement with the Master Agreement. The purpose of this “single agreement” approach is to facilitate close-out netting by avoiding “cherry picking”.

The term “cherry picking” refers to a power that some insolvency officials have under the insolvency laws of certain jurisdictions to reject certain contracts burdensome to the insolvent company while affirming contracts beneficial to the insolvent company.

Generally, where an insolvency official has the power to reject or affirm contracts, a counterparty to a rejected contract must file a claim for moneys owed (or for damages) against the estate of the insolvent company in respect of the rejected contract, for which it can expect to receive no more than a fraction of the value, while continuing to perform its obligations to the insolvent company under any affirmed contracts.

If a bank has a number of swaps with an insolvent company, “cherry picking” results in those swaps which are out-of-the-money to the insolvent company being rejected and those swaps which are in-the-money being affirmed. Assuming the swaps are unsecured, the counterparty is in the disastrous position of being forced to pay *full* value in respect of the swaps which are out-of-the-money to itself while likely to receive only *part* value (if any) in respect of the swaps which are in-the-money to itself.

The ISDA Master Agreement attempts to overcome this problem by making it clear that the Master Agreement and all transactions entered into under it constitute a single agreement between the parties which must therefore be affirmed or rejected by the insolvency official as a whole.

Normally, upon declaration of an early termination date for a Master Agreement by reason of an insolvency default, all transactions are terminated and their value is determined. As noted above, some of these swaps, depending on rates prevailing at the time of termination, may be in-the-money and some may be out-of-the-money to the non-defaulting party. The values for the swap transactions are converted to a single currency and netted against each other to produce a single “settlement amount”.

The benefits of netting the values of individual transactions upon termination are clear. Suppose a bank had entered into four interest rate swaps with a counterparty which subsequently became insolvent and that on the date the insolvency petition was presented the values of those swaps to the bank were as follows:

Swap 1:	U.S.\$ 7	million
Swap 2:	U.S.\$ 5	million
Swap 3:	U.S.\$ -6	million
Swap 4:	U.S.\$ -3	million

Positive figures indicate that the bank is in-the-money and that the swap is, in that sense, an asset for the bank. Negative figures indicate that the bank is out-of-the-money and that the swap is, in that sense, a liability for the bank.

Assume that the transactions were terminated and valued on the day the petition was presented. If the insolvency official appointed to deal with the counterparty's estate were able to cherry pick, the bank would be obliged to pay U.S.\$9 million, representing the value of the transactions which were, in effect, liabilities of the bank and assets of the counterparty. The bank would also have a claim against the insolvent's estate for U.S.\$ 12 million, representing the value of the transactions which were, in effect, assets of the bank and liabilities of the insolvent. Assuming the bank was only paid 10% of its claim against the estate, it would have paid U.S.\$9 million and received U.S.\$1 .2 million.

If close-out netting, on the terms of the ISDA Master Agreement, were enforceable as against the insolvency official, the bank's position would be significantly improved. A single net sum in respect of all the terminated transactions would be calculated equal to U.S.\$3 million (U.S.\$7 million + U.S.\$5 million - U.S.\$6 million - U.S.\$3 million). The bank's claim against the insolvent's estate would therefore be for U.S.\$3 million. Assuming again a 10% pay-out, the bank would receive U.S.\$300,000. The fact the enforceability of close-out netting in the jurisdiction of the bank's counterparty effectively reduces the bank's credit risk from U.S.\$ 19.8 million (U.S.\$9 million + U.S.\$10.8 million) to U.S.\$2.7 million (U.S.\$3 million - U.S.\$300,000).

Exhibit C
STATUS OF NETTING IN SEVERAL JURISDICTIONS

Jurisdiction	ISDA Netting Opinion	Enforceability of Close-Out Netting	Statutory Protection for Netting
Australia	Yes	Yes	Legislation in place
Austria	Yes	Strengthening of current position expected	Legislation in place
Bahamas	Yes	Yes	Position clear under existing insolvency legislation
Belgium	Yes	Yes	Legislation in place
Bermuda	Yes	Yes	Position clear under existing insolvency legislation
Canada	Yes	Yes	Legislation in place
Cayman Islands	Yes	Yes	Legislation in place
Denmark	Yes	Yes	Legislation in place
Finland	Yes	Yes	Legislation in place
France	Yes	Yes	Legislation in place
Germany	Yes	Yes	Legislation in place
Greece	No	Uncertain	Unclear
Hong Kong	Yes	Yes	Position clear under existing insolvency legislation
Indonesia	Yes	Yes	Legislation in place
Ireland	Yes	Yes	Legislation in place
Italy	Yes	Strengthening of current position expected	Legislation under preparation
Japan	Yes	Yes	Legislation in place
Luxembourg	Yes	Yes	Legislation in place
Malaysia	Yes	Yes	Legislation in place
Mexico	Under review	Yes	Legislation in place
Netherlands	Yes	Yes	Position clear under existing insolvency legislation
Netherlands Antilles	Yes	Yes	Legislation in place
New Zealand	Yes	Yes	Legislation in place
Norway	Yes	Yes	Legislation in place
Philippines	Yes	Yes	Legislation in place
Portugal	Yes	Yes	Legislation in place
Scotland	Yes	Yes	Position clear under existing insolvency legislation
Singapore	Yes	Yes	Position clear under existing insolvency legislation
South Africa	Yes	Yes	Legislation in place
South Korea	Yes	Yes	Legislation in place
Spain	Yes	Strengthening of current	Legislation in place

		position expected	
Sweden	Yes	Yes	Legislation in place
Switzerland	Yes	Yes	Legislation in place
Taiwan	Yes	Yes	Legislation in place
Thailand	Yes	Yes	Legislation in place
UK	Yes	Yes	Position clear under existing insolvency legislation
USA	Yes	Yes	Legislation in place