

**Memorandum**

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**INTRODUCTION**

We are pleased to inform you about the recent approval of a new law in Chile that authorizes the netting for certain derivative transactions.

We refer to netting provisions contained in Law No. 20,190-known as “Second Capital Market Law” (the “MKII Law”), which was published in the Official Gazette on June 5, 2007. Among other issues, the MKII Law amended Chilean Bankruptcy Law (the “Bankruptcy Law”) and Chilean Banking Law (the “Banking Law”) expressly recognizing that, in case of bankruptcy or mandatory liquidation procedures, netting could take place with respect to derivative transactions governed by the same master agreement.

**ANALYSIS**

1. Applicable regulation prior to the MKII Law.

A. *Chilean Civil Code.* Under Chilean Civil Code, set-off takes place by the sole operation of law, whenever two parties are simultaneously reciprocally creditors and debtors, provided that the following requirements are met: a) both obligations are expressed in money, or are referred to fungible or indeterminate things of a same gender and quality; b) both obligations are liquid (i.e. their value is determined), and c) both obligations are due and payable.

B. *Bankruptcy Law.* Article 69 of the Bankruptcy Law establishes, as a general rule, that bankruptcy declaration prevents any set-off which has not taken place by the sole operation of law before the date of the bankruptcy declaration, between reciprocal obligations of the bankrupt and its creditors, except in the case of connected obligations (“*obligaciones conexas*”), derived from the same agreement or negotiation, regardless their different maturity date.

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This general disposition permitted to argue that even in face of bankruptcy of a Chilean counterparty netting was possible with respect to derivative transactions governed by the same master agreement provided that such agreement had contained a clause providing for the early termination and netting of all outstanding contracts and obligations. Nevertheless, this interpretation had never been discussed nor ratified by a Chilean court and it was possible that a court or regulator would have interpreted or applied this provision in a different manner.

C. *Banking Law.* Banks are not subject to bankruptcy proceedings. In turn, Banking Law provides for a mandatory liquidation procedure in case of insolvency of banks. Prior to the MKII Law, Article 136 of Banking Law established that whenever a creditor was at the same time a debtor of the bank, netting should only take place at the time of the corresponding distributions of funds made during the mandatory liquidation procedure of the insolvent bank conducted by the Superintendency of Banks, provided the other legal requirements were also meet.

### 2. Netting provisions of the MKII Law.

A. *Bankruptcy Law.* The MKII Law included three new paragraphs to article 69 of Bankruptcy Law expressly recognizing as “connected obligations” those that derive from derivative transactions entered into between the same parties under the same master agreement, provided the master agreement: (a) has been duly recognized by the Central Bank of Chile (“Central Bank”), and (b) includes netting provisions in case of bankruptcy (non-banking counterparty) or mandatory liquidation (banking counterparty).

Please note that the MKII Law expressly authorizes that: (i) the obligations may be agreed in different currencies, and (ii) the derivative contracts under the same master agreement may be entered into in one or more opportunities and under Chilean or foreign law.

Central Bank will be able to determine the terms and general conditions of the above-mentioned master agreements, in which a bank or any other institutional investor may be a part of, considering for these purposes master agreements generally accepted in international markets.

Up to this date, Central Bank has not determined neither which master agreements are going to be recognized for these purposes, nor the terms and conditions that such master agreements shall contain in case of agreements entered into by banks or institutional investors.

For the purposes of netting under the provisions of the MKII Law, each of the obligations derived from derivative transactions will be consider as currently due, liquid and immediately enforceable as of the date of the bankruptcy declaration and its value shall be calculated as of such date based on the terms of the master agreement. Therefore, provided that the

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requirements set forth in MKII Law are met, netting is permitted on the bankruptcy declaration's date.

B. *Banking Law.* The MKII Law modified Article 69 No. 6 of Banking Law expressly authorizing banks to operate with derivative products, such as futures, options, swaps, forwards and others derivatives instruments or contracts, in accordance to the rules and limitations established by the Central Bank.

Likewise, the MKII Law modified Article 136 of Banking Law establishing that, beside the netting procedure described in Section 1.C above, netting of connected obligations derived from derivate transactions entered into by banks in accordance to article 69 No. 6 of Banking Law, shall also take place during a mandatory liquidation procedure, pursuant to the provisions described in Section 2.A above.

C. *Effectiveness date.* Netting provisions of MKII Law are in force since June 5, 2007. Nevertheless, in case of derivate transactions entered into by banks or institutional investors, netting provisions will be effective 120 days as of June 5, 2007.

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