

# ISDA

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7 August 2003

**Khun Sawangchit Chaiyawat**  
**Assistant Governor**  
**Financial Institutions Policy Group**  
**The Bank of Thailand**  
**Building 3 - 273 Samsen Road**  
**Bangkhunprom Bangkok 10200**  
**Thailand**

Dear Khun Swangchit Chaiyawat

**Re: Application of ISDA Master Agreement to Bank of Thailand's Notification No 65-2546**

I am writing to you on behalf of the International Swaps and Derivatives Association ("ISDA"), concerning the above matter.

As you may be aware, ISDA is the leading global trade association in the privately negotiated or over-the-counter derivatives industry with over 600 members from 46 countries worldwide. These members include most of the world's major institutions, which deal in over-the-counter derivatives, including commercial banks, merchant banks, investment banks, corporations and other institutions. An overview of ISDA's membership is enclosed.

Since its inception, ISDA has pioneered efforts to identify and reduce the sources of risk in the derivatives and risk management business. Among its most notable accomplishments are: developing the ISDA Master Agreement; publishing a wide range of related documentation materials and instruments covering a variety of transaction types; producing legal opinions on the enforceability of netting and collateral arrangements; securing recognition of the risk-reducing effects of netting in determining capital requirements; promoting sound risk management practices, and advancing the understanding and treatment of derivatives and risk management from public policy and regulatory capital perspectives. Please find enclosed a copy of ISDA's mission.

ISDA welcomes the improvements made to the calculation methods of obligations for exchange rate contracts and interest rate contracts in the Notification No 65-2546 Re: "Prescription on Ratio of Credits Granted, Investments and Contingent Liabilities by a Commercial Bank to Any Person to its Capital Funds" (the "Notification") dated 2 May 2003.

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While the Notification represents a step towards best practices currently employed around the world, our members have queried whether the 1992 ISDA Master Agreement (Multicurrency – Cross Border) and the 2002 ISDA Master Agreement are netting agreements which fulfill the conditions stipulated by the Bank of Thailand. For your ease of reference, we have enclosed a copy of both the 1992 ISDA Master Agreement and the 2002 ISDA Master Agreement.

Reviewing the conditions stipulated, we are of the opinion that both, the 1992 and the 2002 ISDA Master Agreements, satisfy the criteria specified in the Notification. We have attached (see Annex A), an overview of why we believe the ISDA Master Agreements should be deemed to be suitable netting agreements.

We would be very grateful if the Bank of Thailand could review the attached and confirm that the ISDA Master Agreements fulfill all the conditions laid out in the Notification and therefore are recognized as valid netting agreements according to the conditions stipulated by the Bank of Thailand.

For your reference we have also included a complimentary copy of the recent netting opinions which ISDA has commissioned from local legal counsel on Thailand.

We look forward to your feedback on this matter. In the meantime, if you have any questions in relation to the attached or require any further information, please do not hesitate to contact my colleague, Mr Chiang Kheng Hong, or myself.

Yours sincerely,



**Angela Papesch**  
Head of Asia-Pacific Office

Cc:  
**Mr Samart Buranawatanachoke**  
Senior Director, Financial Institutions Policy Group

Conditions set by Bank of Thailand which both the 1992 and the 2002 ISDA Master Agreement need to fulfill in order to qualify as valid netting agreements:

(1) ***It is a written agreement with enforceability and is a master agreement covering all exchange rate contracts and interest rate contracts that the bank has entered with a counterparty.***

A: The ISDA Master Agreement is the written document used globally by market participants (including banks and corporates) to document, on a bilateral basis, a vast number of OTC derivative transactions, including exchange rate contracts and interest rate contracts. ISDA has also obtained legal opinions from 39 jurisdictions on the enforceability of some of the principal provisions of the ISDA Master Agreement. (Please see (3) below.)

(2) ***In case that any party defaults, becomes bankrupt, terminates his business or if there is other similar circumstance, a netting agreement must require that the commercial bank repay money to the counterparty or to be repaid by the counterparty in a single legal obligation, where the total net amount must be a total net amount of the profit and loss resulted from a mark to market value of all exchange rate and interest rate contracts that the commercial bank has entered with that counterparty.***

A: Both the 1992 and the 2002 ISDA Master Agreements provide for a net obligation to be determined in the case of a bankruptcy or similar events. The ISDA Master Agreement provides that, among other things, following the bankruptcy of a party, the other party will have the right to terminate all transactions entered into between the parties under the agreement. The definition of "Bankruptcy" in section 5(a)(vii) of the agreement is widely drafted and encompasses various circumstances under which a party has become or is becoming insolvent, including the winding-up of the party, its inability to pay its debts, the appointment of an insolvency official, the enforcement of security against it and other similar events. We believe that the definition is sufficiently wide to encompass the types of circumstances envisaged by the Bank of Thailand as set out in this condition.

Following the occurrence of a bankruptcy event, if the relevant party so elects, all transactions under the agreement will be terminated. Section 6 of the ISDA Master Agreements allows the parties to determine the mark-to-market value of each transaction (the procedure for making such determinations is set out in the agreement) and a net amount, based on such mark-to-market values across all transactions, will be payable by one party. This amount represents the single amount that is payable by one or the other party to the agreement upon the termination of the transactions.

- (3) ***An independent legal advisor has expressed his opinion in writing that netting in (2) is enforceable under the laws of:***  
***(3.1) Laws of the country where the head office of a juristic person, which is a counterparty, is located. In addition, if the counter party is a branch of a foreign entity, the netting must also not conflict with the laws governing where the branch of such juristic person is located.***  
***(3.2) laws governing such transactions and other laws relating to the netting.***

A: In the interest of our membership, ISDA has spent significant resources focusing on the need for close-out netting under the ISDA Master Agreements to be enforceable in any jurisdiction in which institutions may be actively trading OTC derivatives. ISDA spends notable time and efforts to ensuring that regulators realize the benefit of close-out netting and in jurisdictions where the legal and regulatory framework casts doubt on the enforceability of close-out netting, ISDA seeks to engage in a dialogue with relevant authorities to discuss the benefit of legal and regulatory reform.

To assist institutions with the assessment of whether close-out netting in any particular jurisdiction is enforceable, ISDA has commissioned independent legal opinions from local legal counsel on the enforceability of the relevant provisions under the ISDA Master Agreements. These opinions are obtained in 39 jurisdictions (a full list of ISDA opinions is available on the ISDA website: [http://www.isda.org/docproj/stat\\_of\\_net\\_opin.html](http://www.isda.org/docproj/stat_of_net_opin.html)) and updated annually. The actual opinions are available from the ISDA website to all ISDA members.

- (4) ***There is no walkaway clause. A walkaway clause is provision which permits a non-defaulting counterparty to make only limited payment, or no payment at all, to the estate of defaulter, even if the defaulter is a net creditor.***

The 2002 ISDA Master Agreement contains no walk-away clause. Following the determination of the single net Early Termination Amount, the party by which this amount is payable will have the obligation to make the payment in full, irrespective of whether or not it is the defaulting party or a party affected by the relevant termination event.

The position is the same in the 1992 ISDA Master Agreement under the so-called "Second Method" payment method in Section 6(e)(i). Although the 1992 ISDA Master Agreement provides for a payment method (the so-called "First Method") under which the non-defaulting party has no obligation to pay the net termination amount, this payment method only applied upon election of the parties. As a result of the requirements of banking supervisory bodies in various countries, market participants now invariably elect for the Second Method to apply.

The removal of the First Method in the 2002 ISDA Master Agreement further acknowledges that market participants perceive this payment method to be obsolete.