



International Swaps and Derivatives Association, Inc.  
24 Raffles Place  
#22-00 Clifford Centre  
Singapore 048621  
Telephone: (65) 6538-3879  
email: [isdaap@isda.org](mailto:isdaap@isda.org)  
website: [www.isda.org](http://www.isda.org)

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**Ms Lim Lee Na/Lim Tai Ching**  
**Perbadanan Insurans Deposit Malaysia**  
**P.O. Box 13071**  
**50798 Kuala Lumpur**

By Courier and E-mail  
E-mail: [legal@pidm.gov.my](mailto:legal@pidm.gov.my)

Dear Lee Na and Tai Ching

**PIDM CONSULTATION PAPER ON PROPOSED AMENDMENTS TO THE MALAYSIA DEPOSIT INSURANCE CORPORATION ACT 2005 (“MDIC ACT”) AFFECTING CERTAIN FINANCIAL TRANSACTIONS**

1. ISDA and its members greatly appreciate the opportunity to provide feedback and comments on the above Consultation Paper issued by Perbadanan Insurans Deposit Malaysia (“PIDM”) on 30 June. ISDA and its members would like to state at the outset that we believe the above Consultation Paper represents a big step in the right direction towards achieving the goal of close-out netting and collateral enforceability for Malaysian counterparties.
2. Specifically, we support the following proposals which address a number of concerns that currently arise with the existing MDIC Act:
  - (a) the proposal to amend the current definition of “affected person” to explicitly exclude member institutions so that the conservatorship provisions will not be applicable to member institutions;
  - (b) the proposal to extend the safe harbor for “qualified financial transactions” (“QFTs”) which currently applies only to the assumption of control over a member institution to the appointment of a conservator over an affected person;
  - (c) the proposal to explicitly set out that PIDM must decide within a specified time whether it wishes to transfer QFTs to a “qualified third party” without “cherry-picking” and the inclusion of a statutory “transfer instrument” mechanism.
3. We set out below the points with which our members disagree or on which further clarification is requested:
  - 3.1 **Temporary delay period.** Members disagree with the imposition of a temporary delay period of ten (10) days. In reaffirming its support for close-out netting, the Basel Committee on Banking Supervision (“BCBS”) called for a short delay to termination

and close-out of financial contracts with insolvent financial institutions in order to allow time to transfer the insolvent firm's financial contracts to a solvent firm. Any temporary delay should be kept as short as possible in order to balance the goal of providing the regulator the flexibility to exercise transfer rights while also balancing the market need for prompt close-out so as to alleviate the risk of market movement during the period of the stay and to take advantage of regulatory capital relief.

The U.S. Dodd-Frank Wall Street Reform and Consumer Protection Act which has recently been passed maintains the current position under the Federal Deposit Insurance Act (the “**FDIA**”), i.e., where the Federal Deposit Insurance Corporation (“**FDIC**”) is appointed as receiver<sup>1</sup>, the FDIA provides that a party to a qualified financial contract (“**QFC**”) will be entitled to enforce any contractual right to terminate, liquidate, net and offset such a contract as a result of the appointment of the receiver or the insolvency or financial condition of the depository institution unless the receiver transfers all QFCs between the counterparty, its affiliates and the failed institution to another institution and provides notice of the transfer to the counterparty **by 5 p.m. on the business day after such appointment**. The initial proposal to extend the stay period from one to three business days was in the end rejected.

In the case of an affected person, it would be departing from the norm to confer such stay powers in respect of financial contracts to which ordinary corporates are party. The BCBS recommendations are driven by the aim of preserving financial and market stability and are thus confined to financial institutions, the failure of which may give rise to systemic risk concerns.

Thus, we submit as follows:

- (a) In relation to member institutions, the temporary delay period should not be longer than one business day after the assumption of control. Given the oversight and supervisory function that Bank Negara Malaysia (“**BNM**”) exercises over member institutions, BNM would no doubt already be in possession of all relevant information regarding the member institution before PIDM is requested to assume control over the member institution.
- (b) In relation to affected persons, there should be no temporary delay period at all.

3.2 **Early termination notice.** Section 76(1)(f) of the MDIC Act provides that “*no person may terminate ... any agreement with the member institution ... as from the date of assumption of control of the member institution..*”. Pursuant to Section 6(a) of the ISDA Master Agreement, the Non-defaulting Party “*may, by not more than 20 days notice to the Defaulting Party ... designate a day not earlier than the day such notice is effective as an Early Termination Date in respect of*

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<sup>1</sup> As receiver, the FDIC's purpose is to liquidate and wind up the affairs of the depository institution. The FDIC may be appointed as conservator instead of receiver. However, as conservator, the FDIC's purpose is to operate the depository institution as a going concern. Thus, conservatorship is less drastic than receivership. In the case of conservatorship, the FDIC succeeds to the rights and obligations of the depository institution. Since the party is protected by the FDIC's obligation to continue to perform, a party to a QFC is not able to terminate the contract based solely upon the appointment of the FDIC as conservator. Any default subsequent to this succession, such as failure to make a payment, may result in termination of the contract.

*all outstanding Transactions*”. In other words, there may be a time gap (which will, at most, be 20 calendar days) between the date on which the early termination notice is delivered by the Non-defaulting Party and the date which is designated as the Early Termination Date. We believe that market participants have assumed that the effect of Section 76(1)(f) is that so long as the early termination notice has been delivered before the date of assumption of control of the member institution, it will be effective even though the designated Early Termination Date falls after the date of assumption of control. This is the logical outcome since the early termination notice is effective once delivered and the Non-defaulting Party has no right to unilaterally revoke, withdraw or amend the early termination notice. Further, the Non-defaulting Party will likely have taken action in respect of the related hedges once it has delivered the early termination notice and would not be able to reverse such action. Nevertheless, as the interpretation of Section 76(1)(f) is not entirely free from doubt, it would be helpful for this to be explicitly clarified in the amended statute.

**3.3 Right of PIDM to terminate.** Before providing feedback on this proposal, we would request PIDM to provide further details. In particular, when would this statutory right of PIDM arise, what would be the pre-requisites for a determination by PIDM that it would be “appropriate” to exercise this right, and how would this right be exercised? Our members also wish to reiterate that it is of critical importance to the smooth functioning of business and commerce that the sanctity of contracts freely entered into be upheld and that regulatory authorities should be slow to impose extra-contractual remedies.

**3.4 Transfer provisions.** We request confirmation and clarification of the following points:

- (a) The Consultation Paper states that there will be no “cherry-picking” of QFTs with the failed financial institution/affected person and either all or none of the QFTs between the “same parties” will be transferred out. Please confirm that this applies to all QFTs between (i) the counterparty and the failed institution/affected person and (ii) the counterparty’s affiliates and the failed institution/affected person (which is the position under the FDIA). Please also confirm that any transfer will also extend to the transfer of the collateral arrangements between the parties.
- (b) We request PIDM to provide the criteria for a “qualified third party” for consultation and feedback and not, as stated in the Consultation Paper, simply “[publish such criteria] in the Gazette in due course”. The counterparty (and its affiliates) will be compelled to accept a transfer of their QFTs with a failed institution/affected person to the qualified third party and to continue to carry on such transferred QFTs on the same terms and conditions (including as to the collateral requirements). As such, the identity of the qualified third party to whom such transfer can be made is of the utmost relevance.
- (c) We note that “drafting changes” will be made to the description of QFTs. We believe that it would be timely to review the list of transactions that would qualify as QFTs, given the current state of the market and potential future developments. For example, the Policy Statement issued by Danaharta Corporation in May 2009 covers a wider range of transactions such as energy, weather, bandwidth, freight, emissions, inflation and property derivatives and also has a ‘forward-looking’ provision in paragraph (y) of the definition of “Eligible Financial Contracts”. It may also be useful to explicitly provide that physically-settled commodity transactions are covered and to re-consider the

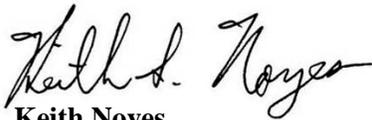
language dealing with Syariah-compliant transactions in paragraph (g) of the Section 80(h) Regulations 2008. Further, we propose that, similar to the Danaharta Corporation Policy Statement, the concept of “Eligible Netting Agreements” be introduced. We would be pleased to provide draft language in this regard for PIDM’s kind consideration.

4. Given that there are a number of details that needs to be clarified, we hope that PIDM will agree that it would be appropriate for an exposure draft of the revised MDIC Act to be made available for comment before enactment.

5. Thank you once again for the opportunity to comment on the proposed changes to the MDIC Act. We would also like to place on record the appreciation of ISDA and its members for all the efforts that PIDM has made in regard to ensuring close-out netting and collateral enforceability for Malaysian counterparties. Please do not hesitate to contact Ms Jacqueline Low ([jlow@isda.org](mailto:jlow@isda.org)) at +65 6538 3879 if you have any questions or require any further information.

Sincerely yours,

**For the International Swaps and Derivatives Association, Inc.**



**Keith Noyes**  
Regional Director, Asia Pacific



**Jacqueline Low**  
Senior Counsel Asia