ISDA

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24 November 2004

Mr. Oleg Vyugin
Head of the Federal Service for Financial Markets
Leninsky Prospekt 9
119991 Moscow
Russian Federation

Dear Mr. Vyugin:

The International Swaps and Derivatives Association, Inc. ("ISDA") is an international financial trade association whose membership includes more than 600 of the world's largest commercial, merchant and investment banks, corporations, government entities and other institutions. ISDA was chartered in 1985 and today represents institutions from 47 countries on six continents. Its members are the leading participants in the privately negotiated, or over-the-counter ("OTC"), derivatives industry. The OTC derivatives industry includes interest rate, currency, commodity, credit and equity swaps, options and forwards, and related products such as caps, collars, floors, and swaptions. The most commonly entered into OTC derivatives transactions under ISDA documentation are described in Appendix A to this letter.

ISDA is committed to promoting the development of sound risk management practices. Its work includes efforts to ensure adequate legal and regulatory treatment of OTC derivatives transactions. Market participants and key regulators view ISDA as a responsible contributor in the debate on how best to manage the risk associated with OTC derivatives transactions. In particular, ISDA has worked with regulators in jurisdictions around the world to promote the legal enforceability of the close-out netting mechanism in the ISDA Master Agreement, which is the leading standard form documentation for international OTC derivatives transactions worldwide.

The purpose of this letter is to continue a dialogue on the enforceability in Russia of critical provisions of the ISDA Master Agreement, particularly those that relate to close-out netting. As you may know, ISDA has worked previously with the Russian Federation State Duma Committee on Credit Organizations and Financial Markets and the Committee on Property to advise on proposed legislation relating to the regulation of financial derivatives. Accordingly, ISDA would be happy to provide you with all prior correspondence and the background materials that ISDA has previously submitted in this respect. This includes comments by ISDA submitted in July 2003 relating to a then-draft text for a Federal Law on Derivatives.

We understand that there is continuing interest in Russia in improving legal certainty, the standing of Russia's financial markets in the world and statutory support for the enforceability of financial derivatives entered into, for example, under the ISDA Master Agreement. This interest also mirrors that of leading ISDA members from outside the country. On that basis, ISDA would like to offer its assistance to the Russian government as it works to promote legal certainty among international market players with respect to the enforceability of the ISDA Master Agreement, including close-out netting, in Russia. The economic benefits to Russia of such reform would be significant. For example, close-out netting legislation would allow financial institutions to calculate their exposure with Russian counterparties on a net rather than on a gross basis. If a party is able to net its liabilities against its assets, its overall credit risk is considerably reduced. When credit risk in Russia is reduced, leading international financial institutions will be encouraged to increase their credit lines to Russian counterparties. Ensuring the legal enforceability of close-out netting also may reduce capital costs for your local banks and encourage the growth and competitiveness of Russian financial markets.

The need for legal certainty

In light of uncertainty arising from past decisions of Russian courts, derivatives market participants will take comfort from a clear and unequivocal statutory recognition that derivatives trading under contracts, like ISDA's Master Agreements, will not be characterised as gambling under locally applicable law or regulation relating to games, gaming or lotteries and will be enforceable by Russian Courts. Derivatives are not considered "gambling" in the traditional sense in other jurisdictions. For example, both the United Kingdom and the United States have enacted anti-gaming law exemptions to ensure the enforceability of derivatives agreements. In the Russian context, similar modifications could be undertaken with respect to Article 1062 of the Russian Civil Code.

In addition, although there are no laws or regulations in the Russian Federation explicitly stating that close-out netting would not be enforceable, many market participants and legal experts believe that Russian law does not set out a clear position on this issue. Without specific guidance under Russian law, a Russian court might prevent the application of close-out netting in an insolvency proceeding, for example where local policy interests might be seen as overriding the parties' choice of law for their contract.

As a result of such legal uncertainty affecting the derivatives market in Russia, financial institutions and institutional investors inside and outside Russia that deal with Russian counterparties in financial transactions are at a competitive disadvantage because they cannot confidently net their derivatives exposures against their Russian counterparties. Further, many counterparties may require that Russian branches of a multi-branch counterparty be excluded from framework agreements such as the ISDA Master Agreement. This may prevent dealings with the Russian branches altogether, or it may require banks to use separate agreements and more expensive credit lines when dealing with Russian branches. The overall result is that Russian entities may be less able to employ OTC derivatives effectively. To the extent Russian entities do enter into OTC derivatives transactions, they will bear additional costs associated with legal uncertainty over netting.

The benefits of close-out netting

Most documents that are widely used in international financial derivative markets are drafted as a type of master or framework agreement. Each of these master agreements is designed as a master netting agreement under which the parties can enter into a number of different trades and, on close-out, calculate the net exposure between the parties under all of these trades.

Close-out netting in relation to OTC derivative transactions is the ability of a party under a master agreement for such OTC derivative transactions (such as an ISDA Master Agreement) to net the mark-to-market values of all existing transactions under the master agreement upon their early termination following the default of its counterparty or other specified events.

The benefits of close-out netting are risk reduction and cost reduction. The risk reduction is twofold: reduction of credit risk and reduction of systemic risk. Credit risk reduction benefits an individual party by reducing its overall exposure to its counterparty by anywhere from 40 to 60 percent. By reducing credit risk at each node in the network of relationships between market participants, close-out netting also has an important beneficial effect on systemic risk. Appendix B provides a concrete example of how risks and costs may be reduced via close-out netting.

Recognizing the substantial credit and systemic benefits of close-out netting, many jurisdictions where previously there was some doubt about the enforceability of netting have introduced legislation to enable it or, more often, to strengthen it where it was already available. Examples in Europe include Austria, Belgium, Channel Islands, Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Luxembourg, Malta, Norway, Poland, Portugal, Spain, Sweden, Switzerland and Turkey. Examples elsewhere include Australia, Brazil, Canada, Japan, Mexico, New Zealand, South Africa and the United States. A current status report on the enforceability of close-out netting worldwide is attached as Appendix C.

Recognizing the value of close-out netting, the G10 central banks and central banks of other jurisdictions have permitted, subject to prudential conditions, the recognition of netting for capital adequacy and large exposure purposes. Other benefits for market participants include more efficient use of credit lines and the ability to maintain lower reserves to cover exposures.

Important Factors To Consider in Close-Out Netting Legislation

What should the minimum standards of close-out netting legislation include? In accordance with the points discussed above, two central themes that ISDA has emphasised when advocating the adoption of close-out netting legislation are: (1) legal enforceability by ensuring that any statutorily supported netting occurs in accordance with the parties' agreed terms, especially where these reflect a global industry standard, and (2) technical distinctions that need to be considered when distinguishing netting from set-off. Both of these themes are reflected in

ISDA's Model Netting Act, attached as Appendix D. Of course, it should be pointed out that the Model Netting Act is neither intended nor suitable for wholesale adoption, but is rather a catalogue of relevant issues for review as you consider and legislate for the particular circumstances in the Russian Federation. In addition, these materials formed part of an earlier submission made to the Russian State Duma Experts' Committee Meeting held on 18-19 March 2003 in Moscow, and, accordingly, translations made at that time may be available to you.

1. *Legal Enforceability Based on the Contract*. Netting legislation should ensure the enforceability of close-out netting following the occurrence of any contractually agreed termination event or event of default under a netting agreement, both pre- and post-insolvency, in each case in accordance with the terms of the parties' agreement. Reliance by the parties on the expressly agreed terms of their contract, and in particular where these represent standard terms on which business is conducted in the derivatives market, is a key issue for ISDA members. This may require clear and unequivocal statutory recognition that derivatives trading under contracts, such as ISDA's Master Agreements, will be enforceable by Russian courts. In other words, market participants who engage in derivatives transactions pursuant to the ISDA Master Agreement will be concerned if any particular netting legislation can be read to subordinate provisions of the contract to potentially differing statutory requirements.

These concerns are particularly acute in the event of an insolvency of one party to a derivatives transaction. In light of uncertainty arising from the existing Russian insolvency regime, which was adopted before the emergence of the Russian derivatives market, and in the absence of court decisions on point, derivatives market participants will take great comfort from a clear statutory recognition that close-out netting will be enforceable and will take precedence over conflicting insolvency law where appropriate.

- Where insolvency law provides that the liquidator may assume or repudiate contracts ("cherry-picking"), the netting legislation should limit such assumption or repudiation to the net amount due under the netting agreement.

- Where insolvency law prohibits set-off, the netting legislation should provide that close-out netting is not a prohibited form of set-off.

- Where insolvency law provides for a suspect period, the netting legislation should provide that payments under eligible transactions are not to be treated as preferences where such payments were not made with intent to hinder, delay or defraud other creditors.

- "Insolvency proceedings" should be broadly defined to include both proceedings that now exist or may in future arise, including those arising under similar regimes in other jurisdictions. The Bankruptcy Event of Default in the 2002 ISDA Master Agreement may be a good starting point for assessing a statutory definition.

Netting should also be enforceable (in accordance with the terms of the contract) outside of bankruptcy. The netting legislation should, if necessary, be written to provide that such legislation also takes precedence over gaming or similar laws that could invalidate netting agreements on the basis that they are gaming or otherwise unlawful contracts. In the Russian Federation, as mentioned above, this would require explicit acknowledgement that qualifying derivatives contracts shall not be void by reason of any Russian law relating to games, gaming or lotteries.

Furthermore, it is an important issue for ISDA members that any netting legislation should not require "termination" of the agreement. Under ISDA documentation, only trades or transactions terminate and the agreement survives so that the netting provisions in it are enforceable.

2. *Technical Distinctions*. The netting legislation should specify that the only obligation or entitlement due to or from a party to a netting agreement upon close-out netting of transactions is its net obligation or entitlement as determined in accordance with the terms of the agreement. The netting legislation should not provide for set-off of the separate obligations owed under each transaction, but should instead create one net obligation for all transactions. This can be accomplished by specifying in the netting legislation that a netting agreement and all eligible transactions under the netting agreement constitute a single contract. Furthermore, the netting legislation should provide that the inclusion of non-eligible transactions under the netting agreement would not destroy close-out netting for the remaining eligible transactions under the netting agreement. In addition, where collateral arrangements cover some transactions which are eligible transactions and some which are not, the collateral arrangements should remain protected with respect to the eligible transactions. In fact, more generally, you may wish to ensure that collateral arrangements in support of netting agreements are statutorily protected and exempt from any other conflicting collateral law requirements that the collateral taker obtain consent from, or provide notice to, other parties or liquidators prior to realisation of collateral. Increasingly, the derivatives markets look to margin-like arrangements that benefit from standardised terms and that work across global markets in light of the significant and complicated conflict of laws issues that might otherwise arise.

We hope that our comments are helpful to you during your considerations, and ISDA would welcome the opportunity to assist you in achieving a better understanding of issues that might affect the enforceability and economic benefits of close-out netting and of OTC derivatives trading in the Russian Federation. Although the issues discussed in this letter are of particular importance, there are additional points of detail that ISDA would be able to provide as needed. In addition, where helpful, ISDA is fully prepared to continue providing technical assistance in relation to our broader documentation library and market practice in other jurisdictions. If ISDA can be of any help in this process, we hope that you will not hesitate to contact the undersigned at the ISDA New York office, 360 Madison Avenue, 16th Floor, New York, NY, (212) 901-6000 or Peter Werner at the ISDA European Office, One New Change, London EC4M 9QQ, +44 (0) 20 7330 3550, pwerner@isda.org.

Sincerely,

Robert G. Pickel
Executive Director and Chief Executive Officer

APPENDIX A

CERTAIN TRANSACTIONS UNDER THE ISDA MASTER AGREEMENT

Basis Swap. A transaction in which one party pays periodic amounts of a given currency based on a floating rate and the other party pays periodic amounts of the same currency based on another floating rate, with both rates reset periodically; all calculations are based on a notional amount of the given currency.

Bond Option. A transaction in which one party grants to the other party (in consideration for a premium payment) the right, but not the obligation, to purchase (in the case of a call) or sell (in the case of a put) a bond of an issuer, such as Kingdom of Sweden or Unilever N.V., at a specified strike price. The bond option can be settled by physical delivery of the bonds in exchange for the strike price or may be cash settled based on the difference between the market price of the bonds on the exercise date and the strike price.

Bullion Option. A transaction in which one party grants to the other party (in consideration for a premium payment) the right, but not the obligation, to purchase (in the case of a call) or sell (in the case of a put) a specified number of Ounces of Bullion at a specified strike price. The option may be settled by physical delivery of Bullion in exchange for the strike price or may be cash settled based on the difference between the market price of Bullion on the exercise date and the strike price.

Bullion Swap. A transaction in which one party pays periodic amounts of a given currency based on a fixed price or a fixed rate and the other party pays periodic amounts of the same currency or a different currency calculated by reference to a Bullion reference price (for example, Gold-COMEX on the New York Commodity Exchange) or another method specified by the parties. Bullion swaps include cap, collar or floor transactions in respect of Bullion.

Bullion Trade. A transaction in which one party agrees to buy from or sell to the other party a specified number of Ounces of Bullion at a specified price for settlement either on a "spot" or two-day basis or on a specified future date. A Bullion Trade may be settled by physical delivery of Bullion in exchange for a specified price or may be cash settled based on the difference between the market price of Bullion on the settlement date and the specified price.

For purposes of Bullion Trades, Bullion Options and Bullion Swaps, "Bullion" means gold, silver, platinum or palladium and "Ounce" means, in the case of gold, a fine troy ounce, and in the case of silver, platinum and palladium, a troy ounce.

Buy/Sell-Back Transaction. A transaction in which one party purchases a security (in consideration for a cash payment) and agrees to sell back that security to the other party (in consideration for the original cash payment plus a premium).

Cap Transaction. A transaction in which one party pays a single or periodic fixed amount and the other party pays periodic amounts of the same currency based on the excess, if any, of a specified floating rate (in the case of an interest rate cap) or commodity price (in the case of a commodity cap) in each case that is reset periodically over a specified per annum rate (in the case of an interest rate cap) or commodity price (in the case of a commodity cap).

Collar Transaction. A collar is a combination of a cap and a floor where one party is the floating rate or floating commodity price payer on the cap and the other party is the floating rate or floating commodity price payer on the floor.

Commodity Forward. A transaction in which one party agrees to purchase a specified quantity of a commodity at a future date at an agreed price and the other party agrees to pay a price for the same quantity to be set on a specified date in the future. The payment calculation is based on the quantity of the commodity and is settled based, among other things, on the difference between the agreed forward price and the prevailing market price at the time of settlement.

Commodity Option. A transaction in which one party grants to the other party (in consideration for a premium payment) the right, but not the obligation, to purchase (in the case of a call) or sell (in the case of a put) a specified quantity of a commodity at a specified strike price. The option can be settled either by physically delivering the quantity of the commodity in exchange for the strike price or by cash settling the option, in which case the seller of the option would pay to the buyer the difference between the market price of that quantity of the commodity on the exercise date and the strike price.

Commodity Swap. A transaction in which one party pays periodic amounts of a given currency based on a fixed price and the other party pays periodic amounts of the same currency based on the price of a commodity, such as natural gas or gold, or a futures contract on a commodity (e.g., Light Sweet Crude Oil on the New York Mercantile Exchange); all calculations are based on a notional quantity of the commodity.

Credit Protection Transaction.[1] A transaction in which one party pays either a single fixed amount or periodic fixed amounts or floating amounts determined by reference to a specified notional amount, and the other party (the credit protection seller) pays either a fixed amount or an amount determined by reference to the value of one or more loans, debt securities or other financial instruments (each a "Reference Obligation") issued, guaranteed or otherwise entered into by a third party (the "Reference Entity") upon the occurrence of one or more specified credit events with respect to the Reference Entity (for example, bankruptcy or payment default). The amount payable by the credit protection seller is typically determined based upon the market value of one or more debt securities or other debt instruments issued, guaranteed or otherwise entered into by the Reference Entity. Credit protection transactions may also be physically settled by payment of a specified fixed amount by one party against delivery of specified Reference Obligations by the other party. A credit protection transaction may also refer to a "basket" of two or more Reference Entities.

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[1] Some market participants may refer to credit protection transactions as credit swaps, credit default swaps or credit default options.

Credit Spread Transaction. A transaction involving either a forward or an option where the value of the transaction is calculated based on the credit spread implicit in the price of the underlying instrument

Cross Currency Rate Swap. A transaction in which one party pays periodic amounts in one currency based on a specified fixed rate (or a floating rate that is reset periodically) and the other party pays periodic amounts in another currency based on a floating rate that is reset periodically. All calculations are determined on predetermined notional amounts of the two currencies; often such swaps will involve initial and or final exchanges of amounts corresponding to the notional amounts.

Currency Option. A transaction in which one party grants to the other party (in consideration for a premium payment) the right, but not the obligation, to purchase (in the case of a call) or sell (in the case of a put) a specified amount of a given currency at a specified strike price.

Currency Swap. A transaction in which one party pays fixed periodic amounts of one currency and the other party pays fixed periodic amounts of another currency. Payments are calculated on a notional amount. Such swaps may involve initial and or final payments that correspond to the notional amount.

Equity Forward. A transaction in which one party agrees to pay an agreed price for a specified quantity of shares of an issuer, a basket of shares of several issuers or an equity index at a future date and the other party agrees to pay a price for the same quantity of shares of an issuer to be set on a specified date in the future. The payment calculation is based on the number of shares and can be physically-settled (where delivery occurs in exchange for payment) or cash-settled (where settlement occurs based on the difference between the agreed forward price and the prevailing market price at the time of settlement).

Equity Index Option. A transaction in which one party grants to the other party (in consideration for a premium payment) the right to receive a payment equal to the amount by which an equity index either exceeds (in the case of a call) or is less than (in the case of a put) a specified strike price.

Equity Option. A transaction in which one party grants to the other party (in consideration for a premium payment) the right, but not the obligation, to purchase (in the case of a call) or sell (in the case of a put) shares of an issuer or a basket of shares of several issuers at a specified strike price. The option may be settled by physical delivery of the shares in exchange for the strike price or may be cash settled based on the difference between the market price of the shares on the exercise date and the strike price.

Equity or Equity Index Swap. A transaction in which one party pays periodic amounts of a given currency based on a fixed price or a fixed rate and the other party pays periodic amounts of the same currency or a different currency based on the performance of a share of an issuer, a basket of shares of several issuers or an equity index, such as the Standard and Poor’s 500 Index.

EU Emissions Allowance Transaction. A transaction in which one party agrees to purchase a specified quantity of emissions allowances at a future date at an agreed price and the other party agrees to deliver that quantity of emissions allowances for that agreed price.

Floor Transaction. A transaction in which one party pays a single or periodic amount and the other party pays periodic amounts of the same currency based on the excess, if any, of a specified per annum rate (in the case of an interest rate floor) or commodity price (in the case of a commodity floor) over a specified floating rate (in the case of an interest rate floor) or commodity price (in the case of a commodity floor).

Foreign Exchange Transaction. A transaction providing for the purchase of one currency with another currency providing for settlement either on a "spot" or two-day basis or a specified future date.

Forward Rate Transaction. A transaction in which one party agrees to pay a fixed rate for a defined period and the other party agrees to pay a rate to be set on a specified date in the future. The payment calculation is based on a notional amount and is settled based, among other things, on the difference between the agreed forward rate and the prevailing market rate at the time of settlement.

Interest Rate Option. A transaction in which one party grants to the other party (in consideration for a premium payment) the right, but not the obligation, to receive a payment equal to the amount by which an interest rate either exceeds (in the case of a call option) or is less than (in the case of a put option) a specified strike rate.

Interest Rate Swap. A transaction in which one party pays periodic amounts of a given currency based on a specified fixed rate and the other party pays periodic amounts of the same currency based on a specified floating rate that is reset periodically, such as the London inter-bank offered rate; all calculations are based on a notional amount of the given currency.

Physical Commodity Transaction. A transaction which provides for the purchase of an amount of a commodity, such as coal, electricity or gas, at a fixed or floating price for actual delivery on one or more dates.

Repurchase Transaction. A transaction in which one party agrees to sell securities to the other party and such party has the right to repurchase those securities from such other party at a future date.

Securities Lending Transaction. A transaction in which one party transfers securities to a party acting as the borrower in exchange for a payment or a series of payments from the borrower and the borrower's obligation to replace the securities at a defined date with identical securities.

Swap Option. A transaction in which one party grants to the other party the right (in consideration for a premium payment), but not the obligation, to enter into a swap with certain specified terms. In some cases the swap option may be settled with a cash payment equal to the market value of the underlying swap at the time of the exercise.

Total Return Swap. A transaction in which one party pays either a single amount or periodic amounts based on the total return on one or more loans, debt securities or other financial instruments (each a "Reference Obligation") issued, guaranteed or otherwise entered into by a third party (the "Reference Entity"), calculated by reference to interest, dividend and fee payments and any appreciation in the market value of each Reference Obligation, and the other party pays either a single amount or periodic amounts determined by reference to a specified notional amount and any depreciation in the market value of each Reference Obligation.

A total return swap may (but need not) provide for acceleration of its termination date upon the occurrence of one or more specified events with respect to a Reference Entity or a Reference Obligation with a termination payment made by one party to the other calculated by reference to the value of the Reference Obligation.

Weather Index Transaction. A transaction, structured in the form of a swap, cap, collar, floor, option or some combination thereof, between two parties in which the underlying value of the transaction is based on a rate or index pertaining to weather conditions, which may include measurements of heating, cooling, precipitation and wind.

APPENDIX 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 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).

APPENDIX C

STATUS OF NETTING AS OF NOVEMBER 2004

Europe

	ISDA Netting Opinion	Enforceability of Close-Out Netting	Statutory Protection for Netting by way of specific netting legislation or general principles of law
Austria	Yes	Yes	Netting Legislation
Belgium	Yes	Yes	Netting Legislation
Channel Islands	Yes	Yes	Netting Legislation
Czech Republic	No	Yes	Netting Legislation
Denmark	Yes	Yes	Netting Legislation
England	Yes	Yes	General principles of law
Finland	Yes	Yes	Netting Legislation
France	Yes	Yes	Netting Legislation
Germany	Yes	Yes	Netting Legislation
Greece	Yes	Yes	Netting Legislation
Hungary	Yes	Yes	Netting Legislation
Ireland	Yes	Yes	Netting Legislation
Italy	Yes	Yes	Netting Legislation
Luxembourg	Yes	Yes	Netting Legislation
Malta	No	Yes	Netting Legislation
Netherlands	Yes	Yes	General principles of law
Norway	Yes	Yes	Netting Legislation
Poland	No	Yes	Netting Legislation
Portugal	Yes	Yes	Netting Legislation
Russia	No	No	Under Consideration
Slovakia	No	Uncertain	Under consideration
Spain	Yes	Yes	Netting Legislation
Sweden	Yes	Yes	Netting Legislation
Switzerland	Yes	Yes	Netting Legislation
Turkey	Yes	Yes	Netting Legislation

Asia-Pacific

	ISDA Netting Opinion	Enforceability of Close-Out Netting	Statutory Protection for Netting by way of specific netting legislation or general principles of law
Australia	Yes	Yes	Netting Legislation
Hong Kong	Yes	Yes	General principles of law
India	Being commissioned	To be confirmed in ISDA opinion	General principles of law
Indonesia	Yes	Yes	General principles of law
Japan	Yes	Yes	Netting Legislation
Malaysia	Yes	Yes	General principles of law
New Zealand	Yes	Yes	Netting Legislation
Philippines	Yes	Yes	General principles of law
Singapore	Yes	Yes	General principles of law
South Korea	Yes	Yes	General principles of law
Taiwan	Yes	Yes	General principles of law
Thailand	Yes	Yes	General principles of law

Americas

	ISDA Netting Opinion	Enforceability of Close-Out Netting	Statutory Protection for Netting by way of specific netting legislation or general principles of law
Bahamas	Yes	Yes	Netting Legislation
Bermuda	Yes	Yes	Netting Legislation
Brazil	No	Yes	Central Bank decree (Oct 2002)
Cayman Islands	Yes	Yes	Netting Legislation
Canada	Yes	Yes	Netting Legislation
Mexico	Yes	Yes	Netting Legislation
South Africa	Yes	Yes	Netting Legislation
United States	Yes	Yes	Netting Legislation

APPENDIX D

2002 MODEL NETTING ACT

Part I : Netting

1. **Definitions**

In this Act:

"Bank" means the Central Bank of [insert applicable jurisdiction];

"collateral" means:

(i) cash in any currency;

(ii) securities of any kind, including (without limitation) debt and equity securities;

(iii) guarantees, letters of credit and obligations to reimburse; and

(iv) any asset commonly used as collateral in [insert applicable jurisdiction];

“collateral arrangement" means any margin, collateral or security arrangement or other credit enhancement related to a netting agreement or one or more qualified financial contracts entered into thereunder, including (without limitation):

(i) a pledge or any other form of security interest in collateral, whether possessory or non-possessory;

(ii) a security arrangement based on the transfer of title to collateral, whether by outright sale or by way of security, including (without limitation) a sale and repurchase agreement or an irregular pledge; and

(iii) any guarantee, letter of credit or reimbursement obligation by or to a party to one or more qualified financial contracts, in respect of those qualified financial contracts;

"insolvent party" is the party in relation to which an insolvency proceeding under the laws of [insert applicable jurisdiction] has been instituted;

"liquidator" means the liquidator, receiver, trustee or other person or entity which administers the affairs of an insolvent party during an insolvency proceeding under the laws of [insert applicable jurisdiction];

"netting" means the occurrence of any or all of the following:

(i) the termination and/or acceleration of any payment or delivery obligations or entitlements under one or more qualified financial contracts entered into under a netting agreement;

(ii) the calculation or estimation of a close-out value, market value, liquidation value or replacement value in respect of each obligation or entitlement terminated and/or accelerated under (i);

(iii) the conversion of any values calculated or estimated under (ii) into a single currency; and

(iv) the offset of any values calculated under (ii), as converted under (iii);

"netting agreement" means (i) any agreement between two parties that provides for netting of present or future payment or delivery obligations or entitlements arising under or in connection with one or more qualified financial contracts entered into thereunder by the parties to the agreement (a "master netting agreement"), (ii) any master agreement between two parties that provides for netting of the amounts due under two or more master netting agreements (a "master-master netting agreement") and (iii) any collateral arrangement related to one or more of the foregoing;

"non-insolvent party" is the party other than the insolvent party;

"party" means a person constituting one of the parties to a netting agreement;

"person" includes [individuals], [partnerships], [corporations], [other regulated entities such as banks, insurance companies and broker-dealers], [governmental units];

"qualified financial contract" means any financial contract, including any terms and conditions incorporated by reference in any such financial contract, pursuant to which payment or delivery obligations that have a market or an exchange price are due to be performed at a certain time or within a certain period of time. Qualified financial contracts include (without limitation):

(a) a currency, cross-currency or interest rate swap agreement;
(b) a basis swap agreement;
(c) a spot, future, forward or other foreign exchange agreement;
(d) a cap, collar or floor transaction;
(e) a commodity swap;
(f) a forward rate agreement;
(g) a currency or interest rate future;
(h) a currency or interest rate option;
(i) equity derivatives, such as equity or equity index swaps, equity options and equity index options;
(j) credit derivatives, such as credit default swaps, credit default basket swaps, total

return swaps and credit default options;

(k) energy derivatives, such as electricity derivatives, oil derivatives, coal derivatives and gas derivatives;

(l) weather derivatives, such as weather swaps or weather options;

(m) bandwidth derivatives;

(n) freight derivatives;

(o) carbon emissions derivatives;

(p) a spot, future, forward or other commodity contract;

(q) a repurchase or reverse repurchase agreement;

(r) an agreement to buy, sell, borrow or lend securities, such as a securities lending transaction;

(s) a title transfer collateral arrangement;

(t) an agreement to clear or settle securities transactions or to act as a depository for securities;

(u) any other agreement similar to any agreement or contract referred to in paragraphs (a) to (t) with respect to reference items or indices relating to (without limitation) interest rates, currencies, commodities, energy products, electricity, equities, weather, bonds and other debt instruments and precious metals;

(v) any derivative or option in respect of, or combination of, one or more agreements or contracts referred to in paragraphs (a) to (u); and

(w) any agreement or contract designated as such by the Bank under this Act;

"title transfer collateral arrangement" means a security arrangement based on the transfer of title to collateral, whether by outright sale or by way of security, including (without limitation) a sale and repurchase agreement or an irregular pledge.

2. **Powers of the Bank**. The Bank may, by notice issued under this section, designate as "qualified financial contracts" any agreement or contract, or type of agreement or contract, in addition to those listed in this Act.

3. **Enforceability of a Qualified Financial Contract**. A qualified financial contract shall not be and shall be deemed never to have been void or unenforceable by reason of [insert the applicable law] relating to games, gaming and lotteries.

4. **Enforceability of a Netting Agreement**.

(a) General rule. The provisions of a netting agreement will be enforceable in accordance with their terms against the insolvent party and, where applicable, against a guarantor or other person providing security for the insolvent party and will not be stayed, avoided or otherwise limited by any action of the liquidator, by any other provision of law relating to bankruptcy, reorganization, composition with creditors, receivership, conservatorship or any other insolvency proceeding the insolvent party may be subject to or by any other provision of law that may be applicable to the insolvent party, subject to the conditions contained in the applicable netting agreement.

(b) Limitation on obligation to make payment or delivery. The only obligation, if any, of a party to make payment or delivery under a netting agreement shall be equal to its net obligation to the other party as determined in accordance with the terms of the applicable netting agreement.

(c) Limitation on right to receive payment or delivery. The only right, if any, of a party to receive payment or delivery under a netting agreement shall be equal to its net entitlement with respect to the other party as determined in accordance with the terms of the applicable netting agreement.

(d) Limitation on powers of the liquidator. Any powers of the liquidator to assume or repudiate individual contracts will not prevent the termination and/or acceleration of any payment or delivery obligations or entitlements under one or more qualified financial contracts entered into under a netting agreement, and will apply, if at all, only to the net amount due in respect of all of such qualified financial contracts in accordance with the terms of such netting agreement;

(e) Limitation of insolvency laws prohibiting set-off. The provisions of a netting agreement which provide for the offset of close-out values, market values, liquidation values or replacement values calculated in respect of accelerated and/or terminated payment or delivery obligations or entitlements under one or more qualified financial contracts entered into thereunder will not be affected by any applicable insolvency laws limiting the exercise of rights to set off, offset or net out obligations, payment amounts or termination values owed between an insolvent party and another party.

(f) Preferences and fraudulent transfers. The liquidator of an insolvent party may not avoid

(i) any transfer, substitution or exchange of cash, collateral or any other interests pursuant to a netting agreement from the insolvent party to the non-insolvent party, or

(ii) any payment or delivery obligation incurred by the insolvent party and owing to the non-insolvent party pursuant to a netting agreement

on the grounds of it constituting a [preference] [transfer during a suspect period] by the insolvent party to the non-insolvent party, unless there is clear and convincing evidence that the non-insolvent party (i) made such transfer or (ii) incurred such obligation with actual intent to hinder, delay, or defraud any entity to which the insolvent party was indebted or became indebted, on or after the date (i) such transfer was made or (ii) such obligation was incurred.

(g) Preemption. No stay, injunction, avoidance, moratorium, or similar proceeding or order, whether issued or granted by a court, administrative agency, liquidator or otherwise, shall limit or delay application of otherwise enforceable netting agreements in accordance with subsections (a), (b) and (c) of this section of this Act.

(h) Realization and liquidation of collateral. Unless otherwise agreed by the parties, the realization, appropriation and/or liquidation of collateral under a collateral arrangement shall take effect or occur without any requirement that prior notice shall be given to, or consent be received from, any party, person or entity, provided that this subsection is without prejudice to any applicable provision of law requiring that the realization, appropriation and/or liquidation of collateral is conducted in a commercially reasonable manner.

(i) Scope of this provision.

(i) For the purposes of this section, a netting agreement shall be deemed to be a netting agreement notwithstanding the fact that such netting agreement may contain provisions relating to agreements or transactions that are not qualified financial contracts in terms of Part I section 1 of this Act, provided, however, that, for the purposes of this section, such netting agreement shall be deemed to be a netting agreement only with respect to those contracts that fall within the definition of qualified financial contract in terms of Part I section 1 of this Act.

(ii) For the purposes of this section, a collateral arrangement shall be deemed to be a collateral arrangement notwithstanding the fact that such collateral arrangement may contain provisions relating to agreements or transactions that are not a netting agreement or qualified financial contract entered into thereunder in terms of Part I section 1 of this Act, provided, however, that, for the purposes of this section, such collateral arrangement shall be deemed to be a collateral arrangement only with respect to those contracts that fall within the definition of netting agreement or qualified financial contract entered into under a netting agreement in terms of Part I section 1 of this Act.

(iii) For the purposes of this section, a netting agreement and all qualified financial contracts entered into thereunder shall constitute a single contract.

(iv) For the purposes of this section, the term netting agreement shall include the term multibranch netting agreement (as defined in Part II), provided, however, that in a separate insolvency of a branch or agency of a foreign party (as defined in Part II) in [insert applicable jurisdiction] the enforceability of the provisions of the multibranch netting agreement shall be determined in accordance with Part II of this Act.

Part II : Multibranch Netting

1. **Additional Definitions**

In this Act:

"branch/agency net payment entitlement" means with respect to a multibranch netting agreement the amount, if any, that would have been owed by the non-insolvent party to the foreign party after netting only those qualified financial contracts entered into by the branch or agency and the non-insolvent party under such multibranch netting agreement.

"branch/agency net payment obligation" means with respect to a multibranch netting agreement the amount, if any, that would have been owed by the foreign party to the non-insolvent party after netting only those qualified financial contracts entered into by the branch or agency and the non-insolvent party under such multibranch netting agreement;

"foreign party" is a party whose home country is a country other than [insert applicable jurisdiction];

"global net payment entitlement" means the amount, if any, owed by the non-insolvent party (or that would be owed if the relevant agreements provided for payments to either party, upon termination thereof under any and all circumstances) to the foreign party as a whole after giving effect to the netting provisions of a multibranch netting agreement with respect to all qualified financial contracts subject to netting under such multibranch netting agreement;

"global net payment obligation" means the amount, if any, owed by the foreign party as a whole to the non-insolvent party after giving effect to the netting provisions of a multibranch netting agreement with respect to all qualified financial contracts subject to netting under such multibranch netting agreement;

"home country" means the country where a party to a netting agreement is organized or incorporated; "home office" means the home country office of a party to a netting agreement that is a bank;

"multibranch netting agreement" means a netting agreement between two parties under which at least one party enters into qualified financial contracts through - in addition to its home office – one or more of its branches or agencies located in countries other than its home country;

"party" means, for purposes of this Part II, a person constituting one of the parties to a multibranch netting agreement.

2. **Enforceability of a Multibranch Netting Agreement in an Insolvency of a Branch or Agency of a Foreign Party.**

(a) Limitation on the non-insolvent party's right to receive payment.

(i) The liability of an insolvent branch or agency of a foreign party or its liquidator under a multibranch netting agreement shall be calculated as of the date of the termination of such multibranch netting agreement in accordance with its terms and shall be limited to the lesser of (i) the global net payment obligation and (ii) the branch/agency net payment obligation. The liability of the insolvent branch or agency or the liquidator under this section shall be reduced by any amount otherwise paid to or received by the party in respect of the global net payment obligation pursuant to such multibranch netting agreement which if added to the liability of the liquidator under this section would exceed the global net payment obligation.

(ii) The liability of the liquidator of an insolvent branch or agency of a foreign party under a multibranch netting agreement to any party thereunder shall be reduced by the fair market value or the amount of any proceeds of collateral that secures and has been applied to satisfy the obligations of the foreign party pursuant to the multibranch netting agreement.

(b) No limitation on the insolvent party's right to receive payment based on the terms of the multibranch netting agreement. In the event that netting under the applicable multibranch netting agreement results in a branch/agency net payment entitlement, notwithstanding any provision in any such contract that purports to effect a forfeiture of such entitlement, the liquidator may make written demand upon the party to such contract for an amount not to exceed the lesser of (x) the global net payment entitlement and (y) the branch/agency net payment entitlement.

(c) Limitation on the insolvent party's rights to receive payment based on payments made in accordance with insolvency proceedings relating to the foreign party in other jurisdictions. The liability of the non-insolvent party under this section shall be reduced by any amount otherwise paid to or received by the liquidator or any other liquidator or receiver of the foreign party in respect of the global net payment entitlement pursuant to such multibranch netting agreement which if added to the liability of the non-insolvent party under this section would exceed the global net payment entitlement. The liability of the non-insolvent party under this section to the liquidator pursuant to such multibranch netting agreement also shall be reduced by the fair market value or the amount of any proceeds of collateral that secures and has been applied to satisfy the obligations of the non-insolvent party pursuant to such multibranch netting agreement to the foreign party.

(d) Limitation on the terms of the multibranch netting agreement relating to a collateral arrangement. The non-insolvent party to a multibranch netting agreement which has a perfected security interest in collateral, or other valid title, lien or security interest in collateral enforceable against third parties pursuant to such multibranch netting agreement, may retain all such collateral and upon termination of such multibranch netting agreement in accordance with its terms apply such collateral in satisfaction of any claims secured by the collateral, provided that the total amount so applied to such claims shall in no event exceed the global net payment obligation, if any. Any excess collateral shall be returned to the insolvent party.