

# ISDA®

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7 August 2008

**Ms Lim Yam Poh**  
**General Counsel, Legal Division**  
**Perbadanan Insurans Deposit Malaysia**  
**Level 19, 1 Sentral, Jalan Travers,**  
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**50470 Kuala Lumpur**

Dear Yam Poh,

## Close-out Netting

1. ISDA and its members are very appreciative of all the work that Perbadanan Insurans Deposit Malaysia ("PIDM") has done to try to ensure that close-out netting can be recognized by ISDA's members as being enforceable in Malaysia for regulatory capital purposes.
2. As you know, the recognition of the enforceability of close-out netting in Malaysia will bring significant benefits. Exposures can be reckoned on a net instead of gross basis which will result in more efficient use of credit lines and lower reserves being required to satisfy regulatory capital requirements. Lower reserves and posting of collateral for net instead of gross exposures will lead to reduced costs. With reduced costs and greater liquidity in the OTC derivatives markets due to the increased volume of trading that can be undertaken, it will give Malaysian counterparties access to a broader spectrum of risk management tools at a better price. According to the Bank for International Settlements Report of May 2008, as of December 2007, the total notional amount of all outstanding OTC derivatives was US\$596 trillion. The total mark-to-market value of these outstanding transactions was US\$14.5 trillion (2.4% of the notional amount). After applying close-out netting, the total mark-to-market credit exposure was reduced to just US\$3.3 trillion (0.5% of the notional amount), a reduction of 77.6%. The extent to which the enforceability of close-out netting can reduce systemic risk is thus obvious.
3. To recapitulate, the concerns raised by the PIDM Act in relation to the enforceability of close-out netting are as follows:
  - (a) Under Section 27, PIDM has the right to appoint a conservator over an affected person if certain pre-conditions are met. PIDM has the power to acquire assets from member institutions and the obligors under such assets acquired by PIDM are affected persons. Pursuant to the Third Schedule, the appointment of a conservator cannot be treated as giving rise to a right to terminate transactions and upon such appointment, a moratorium

of 12 months (which can be extended) comes into force during which set-off is prohibited except with the prior written consent of PIDM.

- (b) Under Section 71(1)(c), upon receipt of a notification from Bank Negara Malaysia, PIDM or a person appointed by PIDM can assume control over a member institution. Pursuant to Section 76, upon such assumption of control, termination of transactions and set-off are prohibited. Section 80 provides an exemption to the agreements and transactions specified therein from the operation of Section 76.

4. We propose that we differentiate the potential solutions as between banks and non-banks, as the impediments presented by the PIDM Act and the practical considerations are in any case different. We believe that achieving close-out netting enforceability with regard to banks will represent a big step forward. Indeed, the regulatory capital savings are likely to be greater for inter-bank transactions than for bank/non-bank transactions.

5. To achieve close-out netting enforceability with regard to banks, we would urge PIDM to expedite the passage of the Regulations attached to the Consultation Paper of 23 July 2007 which would suitably expand the scope of the exempted agreements and transactions under Section 80. We note that PIDM, in its Response of 13 September 2007 to the feedback received on the Consultation Paper, had confirmed that it would proceed with the Regulations. We recognize that PIDM has expressed the intention of reviewing the PIDM Act and that in the course of such review, the exemption provided by Section 80 may be re-visited. We have no doubt that PIDM will conduct consultations before amending the PIDM Act and we hope to work with PIDM on such an amendment to achieve PIDM's objectives without prejudicing close-out netting enforceability with regard to banks.

6. With regard to non-banks (or affected persons), to recapitulate, the proposal had been for PIDM to issue a Policy Statement that it would give its written consent to the exercise of set-off rights during the moratorium period in relation to the specified "Financial Agreements or Transactions" (which would mirror the exempted agreements and transactions under Section 80). However, before allowing such set-off, PIDM had wanted to reserve, for a "reasonable time", the right to affirm or repudiate all of such transactions if it determined that such affirmation or repudiation would promote the orderly administration of the affected person's affairs. The feedback from respondents had been that such a reasonable time could not be more than one week to 10 days. PIDM's stance, however, was that it would not be practicable for PIDM to arrive at a decision within this period as it may not even be able to obtain the relevant documents and information from the affected person within such period.

7. We would once again urge PIDM to remove this reservation. We reiterate that the Federal Deposit Insurance Corporation does not have the power to appoint a conservator or a receiver over anyone other than the insured depository institution. There is no analogous provision under the Federal Deposit Insurance Act 12 U.S.C. 1821, as amended by the Financial Institutions Reform, Recovery and Enforcement Act of 1989, to that in the PIDM Act giving PIDM the power to appoint a conservator over an affected person. Under the PIDM Act, while the conservator has the power to disclaim 'unprofitable contracts' under Paragraph 16(1)(c) of the Third Schedule, this may not, technically speaking, be equivalent to a right to affirm or repudiate all of the specified Financial Agreements or Transactions if it determined that such affirmation or repudiation would promote the orderly administration of the affected person's affairs. Pending the completion of a thorough review of the PIDM Act, we thus urge PIDM to afford the same protection to the specified Financial Agreements or Transactions undertaken with non-banks as with banks.

8. However, if PIDM cannot remove the reservation from the Policy Statement, we would urge PIDM to commit to a time-frame within which it will decide whether to affirm or repudiate all of the specified Financial Agreements or Transactions and to consider re-wording paragraph 6 of the Policy Statement as follows:

“Paragraph 16(1)(c) of the Third Schedule gives the conservator the power to disclaim ‘unprofitable contracts’. If the Corporation determines that disclaiming all of the eligible Financial Agreements or Transactions will promote the orderly administration of the affected person’s affairs, the conservator will exercise its power of disclaimer. The Corporation intends to make such determination as quickly as possible and in any event no later than [ ] after the appointment of the conservator. The Corporation will also use its reasonable efforts to keep the relevant counterparty to the affected person informed of developments in this regard.”

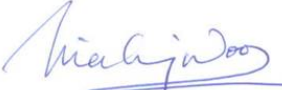
We reiterate that any period longer than 10 days will likely not be sufficient for members to recognize close-out netting enforceability for non-banks for regulatory capital purposes. However, we believe that it would, at least, improve the current position and give members a greater degree of comfort.

9. We would like to thank PIDM once again for all the efforts that it has made in regard to this matter. We look forward to discussing our letter with you any proposals or suggestions that PIDM may have. Please do not hesitate to contact Ms Angela Papesch ([APapesch@isda.org](mailto:APapesch@isda.org)) or 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.**

  
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