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new york

February 16, 2000

MEMORANDUM FOR THE BOND MARKET ASSOCIATION

Re: The Effect of the February 2000 Cross-Product Master Agreement on Rights under The Bond Market Association ("TBMA") Principal Agreements

This memorandum addresses the question of whether entry into the Cross-Product Master Agreement published on February 16, 2000 (the "CPMA") covering a Principal Agreement sponsored by the TBMA or whether providing a Section 2 Notice under the CPMA would, in U.S. insolvency proceedings in respect of the Closed-Out Party, adversely affect the enforceability of the termination, netting and foreclosure provisions of such Principal Agreement or would adversely affect protections given to the Closing-Out Party in respect of the avoidance of fraudulent or preferential transfers made under such Principal Agreement. All capitalized terms not defined herein have the meaning given to them in the CPMA.[1]

We conclude in Part III below, subject to the analysis and qualifications set forth herein, that neither a Closing-Out Party's entry into the CPMA covering such a Principal Agreement nor the provision of a Section 2 Notice under that CPMA would adversely affect the enforceability of the termination, netting and foreclosure provisions of such a Principal Agreement or the protections given to the Closing-Out Party in respect of the avoidance of fraudulent or preferential transfers made under such a Principal Agreement.

[1] This memorandum addresses the effect of the CPMA on the enforceability of such Principal Agreements, but does not address whether the provisions of the CPMA or any such underlying Principal Agreement are, in fact, enforceable. The TBMA has obtained opinions from Clifford Chance Rogers & Wells, LLP and Clifford Chance Limited Liability Partnership, counsel to the TBMA in connection with the drafting of the CPMA, regarding the enforceability of the CPMA under New York and English law. One of these opinions addresses the enforceability of the CPMA in insolvency proceedings in the United States in the case where the netting provisions of the Federal Deposit Insurance Improvement Act of 1991 ("FDICIA") apply. As discussed in the Guidance Notes to the CPMA, the provisions of the CPMA may not be fully enforceable in U.S. insolvency proceedings in the event the netting provisions of FDICIA do not apply, although pending legislation, if enacted, will improve the enforceability of the CPMA in such a case.

This memorandum also does not address the Closing-Out Party's rights to collect any Settlement Amount owing under a Principal Agreement after Close-Out, or the effect of the CPMA on such collection rights. As noted below, the CPMA can, in certain circumstances, operate to delay or accelerate the Closing-Out Party's collection rights.

Furthermore, this memorandum does not address the effect, if any, on the rights of a Closing-Out Party if the Parties to the CPMA have adopted Part VIII of the Schedule to the CPMA or if the parties have included any additional terms and conditions in Part II.3 or Part IX of the Schedule to the CPMA.

This memorandum addresses the following Principal Agreements sponsored by the TBMA (the "TBMA Agreements"):[2]

(a) The September 1996 version of the Master Repurchase Agreement (the "MRA");

(b) The November 1995 version of the Global Master Repurchase Agreement (the "GMRA") (sponsored jointly with the International Securities Market Association);

(c) The Master Securities Loan Agreement, whether or not amended by the April 1998 Amendment to the Master Securities Loan Agreement[3] (the "MSLA");[4]

(d) The Master Securities Forward Transaction Agreement (the "MSFTA"); and

(e) The Master Dealer Agreement, OTC Transactions -- U.S. Treasury Securities (the "MDA").[5]

This memorandum is limited to the federal laws of the United States and the laws of the State of New York[6] and covers only proceedings under Chapters 7 and 11 of the federal Bankruptcy Code (the "Code"), proceedings under the Federal Deposit Insurance Act ("FDIA") in respect of institutions organized under the laws of the United States or a State thereof, and proceedings under the Securities Investor Protection Act of 1970 ("SIPA").[7]

We have assumed that the CPMA is governed by New York law, that each of the TBMA Agreements (other than the GMRA) is governed by New York law, that the GMRA is governed by the laws of England, and that no substantive modifications have been made by the Parties to the CPMA or any of the TBMA Agreements (including, without limitation, the

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[2] Although this memorandum only addresses the TBMA Agreements, the analysis in Section III below should be equally applicable to other New York-law governed agreements (whether Principal Agreements or Uncovered Transactions).

[3] The April 1998 Amendment to the Master Securities Loan Agreement implements a number of statutory and regulatory developments, including in connection with the scope of permitted securities lending transactions.

[4] The TBMA is in the process of revising the MSLA in cooperation with the Securities Industry Association.

[5] The TBMA is in the process of revising the MDA.

[6] The question of whether the CPMA would adversely affect the rights of a Closing-Out Party under an English-law governed GMRA in a U.S. insolvency proceeding would seem principally to be a question of U.S. law. Nevertheless, there may be an adverse effect on such rights if the CPMA had an adverse effect on the GMRA under English law. However, attorneys in our firm qualified to practice English law have advised us that, subject to the assumptions, analysis and qualifications set forth in this memorandum, neither a Closing-Out Party's entry into a CPMA covering the GMRA nor the provision of a Section 2 Notice under that CPMA would under current English law adversely affect the enforceability of the Closing-Out Party's termination and netting rights under the GMRA.

[7] This memorandum does not cover, for example, insolvency proceedings in countries other than the United States, insolvency proceedings under state banking or insurance law, or proceedings under Chapter 9 (municipalities) or Section 304 (ancillary proceedings) of the Code.

addition by means of an Annex or otherwise of any provisions relating to termination, netting, setoff and foreclosure under or across any of the TBMA Agreements).[8] We have also assumed that none of the additional acknowledgments and representations in Part III of the Schedule to the CPMA are inconsistent with any acknowledgments or representations in any TBMA Agreement.

I. The Operation of the Cross-Product Master Agreement

There are three basic operational steps in the CPMA: first, the occurrence of a Close-Out Event under one Principal Agreement or the breach of representations or warranties under the CPMA permits[9] the Close-Out of all (but not fewer than all) Principal Agreements which in the good faith judgment of the Closing-Out Party legally may be Closed Out under applicable law, and results in the Close-Out of those Principal Agreements upon the provision of a Section 2 Notice; second, Settlement Amounts are determined according to the terms of each Closed-Out Principal Agreement (taking into account the exercise of setoff rights, rights against collateral and rights against third party credit support); and third, those Settlement Amounts are themselves set off and netted (unless, in the good faith judgment of the Closing-Out Party it is unlawful to do so) to obtain a single Final Net Settlement Amount due.

A. The Mechanism For Close-Out (Section 2)

Under the CPMA, an event which allows a Party to Close Out a Principal Agreement becomes a contractual basis for such Party to Close Out all (but not fewer than all) other Principal Agreements which in the good faith judgment of the Closing-Out Party legally may be Closed Out under applicable law. In addition, the breach of a representation, warranty or covenant under the CPMA by a Party will entitle the other Party to Close Out all (but not fewer than all) Principal Agreements which in the good faith judgment of the Closing-Out Party legally may be Closed Out under applicable law. The Closing-Out Party is required to provide a Close-Out Notice to the other Party stating that all such Principal Agreements have by virtue of the

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[8] As discussed in the Guidance Notes to the CPMA, the Parties to the CPMA should consider the effect of the CPMA on such provisions in their Principal Agreements or Uncovered Transactions. In this regard, we do not address the effect of the CPMA on Annex III (Alternative Mark-to-Market Provisions) to the MSFTA.

[9] If the Parties choose to make application of the CPMA mandatory through an election under Part VII.3 of the Schedule thereto, the CPMA could require the Close-Out of TBMA Agreements earlier than under the TBMA Agreements themselves (although in most cases the TBMA Agreements provide for automatic Close-Out on insolvency). In this regard, we note that under the Code, the FDIA and SIPA, the trustee, receiver or conservator for the Closed-Out Party could likely terminate the TBMA Agreements prior to any Close-Out by the Closing-Out Party. We also note that there is the risk that damages allowed to the Closing-Out Party would be measured as of the commencement of insolvency proceedings (even if the Closing-Out Party Closed Out a TBMA Agreement or calculated a Settlement Amount thereafter). See, e.g., Tew v. Arizona Retirement System, 69 B.R. 608 (S.D.Fla. 1987), rev'd on other grounds, 873 F.2d 1400 (11th Cir. 1989) (Buyer under repurchase agreement not entitled to recoup interest that had accrued during the two-day period between the appointment of an equity receiver for the Seller (ESM Government Securities) and the Buyer's liquidation of the securities purchased under the repo); 12 U.S.C. § 1821(e)(3) (damages for repudiation or disaffirmance by the Federal Deposit Insurance Corporation ("FDIC") as conservator or receiver measured as of date of appointment). The FDIA contains provisions that reduce this risk in the case of "qualified financial contracts," and pending legislation, if enacted, would reduce this risk under the Code and SIPA in the case of certain transactions and creditors.

notice been Closed Out as of a single specified date except for those otherwise Closed Out prior to the delivery of the Close-Out Notice. In this regard, the CPMA amends the Principal Agreements to:

(i) specify events which constitute an additional basis for Close-Out of all Principal Agreements, and

(ii) override any notice, cure period or other provision that would have otherwise postponed an immediate Close-Out of the Principal Agreements in those circumstances.

All other Close-Out Events, including those automatically terminating a Principal Agreement due to the occurrence of events such as bankruptcy and insolvency, would remain unchanged.

All Closed-Out Agreements – i.e., all Principal Agreements which have been Closed Out according to their terms on or prior to the date a Close-Out Notice is given, and all Principal Agreements Closed Out by such Close-Out Notice – are subject to the netting provisions of Sections 3 and 4 of the CPMA, unless all Principal Agreements have been Closed Out automatically by their terms and the Closing-Out Party does not give notice that it wishes the provisions of Sections 3 and 4 of the CPMA to apply.

B. Determining Settlement Amounts (Section 3)

The mechanisms for valuing transactions under a particular Principal Agreement that has been Closed Out, netting and setting off obligations thereunder, applying margin or collateral to obligations under such Principal Agreement, and other procedures for determining a Settlement Amount due under such Principal Agreement are to be determined by the terms of such Principal Agreement. The CPMA does not modify those provisions of the Principal Agreements.[10] To the extent collateral or other credit support has been applied to the payment obligations under any Principal Agreement, the CPMA provides that the Settlement Amount shall be reduced by the application of such collateral or other credit support.[11] Section 3.3 of the CPMA amends the Principal Agreements so as to defer the settlement of Settlement Amounts in certain circumstances where other Settlement Amounts are yet to be determined.[12]

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[10] This structural feature of the CPMA is the principal basis for the conclusion that the CPMA does not adversely affect a Closing-Out Party's rights, as discussed in more detail below.

[11] As discussed in the Guidance Notes to the CPMA, rights to apply collateral to a net obligation owed under a Principal Agreement or to call on a guarantee of payment of a net obligation owed may be lost once the net obligation is set off in the "rolling" setoff process established in Section 4 of the CPMA. To the extent the Closing-Out Party does not, or is unable to, liquidate collateral or draw on third-party credit support prior to the setoff of the obligation secured thereby pursuant to the CPMA, the CPMA could potentially adversely affect the Closing-Out Party's rights.

[12] Although this provision of the CPMA does not affect the termination, netting, and foreclosure provisions of the Principal Agreements, it may delay the date on which a payment would otherwise be due from the Closed-Out Party.

C. The Setoff Process (Section 4)

Under Section 4.1 of the CPMA, the obligation of a party to settle a Settlement Amount is deferred (with interest accruing at the relevant interest rate specified in the relevant Principal Agreement) from the date on which it would otherwise be due under the Principal Agreement until a date on which each party owes a Settlement Amount to the other.[13] The amounts are translated into a single Base Currency before being set off against one another.[14] On that date, the Settlement Amounts are set off against each other under the CPMA and a Net Set-Off Amount is determined. That Net Set-Off Amount (with interest accruing thereon at the rate specified in Section 4.5(b) of the CPMA) is then carried forward for setoff against the next Settlement Amount subsequently determined to be due from the other Party. Upon completion of the determination of all Settlement Amounts and these "rolling" setoffs, a single final net sum (the Final Net Settlement Amount) is owed under the CPMA by one Party to the other on the Final Settlement Date.

II. The TBMA Agreements[15]

A. The Master Repurchase Agreement

The MRA is governed by the laws of the State of New York. Under the MRA, the parties enter into Transactions in which one party ("Seller") agrees to transfer to the other ("Buyer") securities or other assets ("Securities") against the transfer of the Purchase Price by Buyer, with a simultaneous agreement by Buyer to transfer to Seller such Securities at a date certain or on demand, against the transfer of the Repurchase Price by Seller. In addition to these transfers, between the Purchase and Repurchase Dates, Paragraph 4(a) of the MRA provides for Seller to transfer cash or Additional Purchased Securities to Buyer when the aggregate Market Value of the Purchased Securities is below the Buyer's Margin Amount and Paragraph 4(b) of the MRA provides for the transfer of cash or Purchased Securities from Buyer to Seller when the aggregate Market Value of the Purchased Securities exceeds the Seller's Margin Amount. Under Paragraph 5 of the MRA, Buyer is obligated to pay to Seller (or reduce the Repurchase Price by) an amount equal to income received in respect of the Puchased Securities. Paragraph 6 of the MRA provides for the grant by Seller to Buyer of a security interest in all of the Purchased Securities and their proceeds in the event that a Transaction is deemed to be a loan rather than a purchase and a sale. Paragraph 9 provides for substitution of Purchased Securities in certain circumstances. Under Paragraph 11 of the MRA, on the occurrence of an Event of Default, the nondefaulting party may declare an Event of Default to have occurred, resulting in the Close-Out

[13] If, however, the Closing-Out Party makes a good faith judgment that it is unlawful to include any Settlement Amount in this setoff procedure, Section 3.3 excludes that amount from the procedures under Section 4.

[14] If the Base Currency chosen by the parties in the CPMA is different from the currency of payment under a Principal Agreement, the Closing-Out Party's rights to payment under such Principal Agreement could be affected after termination, netting and foreclosure under such Principal Agreement.

[15] The descriptions of the TBMA Agreements below are very general and, in any event, the parties to the TBMA Agreements can amend such Agreements. In the descriptions of the TBMA Agreements below, all capitalized terms not otherwise defined in this memorandum or in the CPMA have the meanings given to such terms in the relevant TBMA Agreement.

of the MRA and the calculation by the nondefaulting party of a Settlement Amount due in respect of the MRA.[16]

B. The Global Master Repurchase Agreement

The GMRA is governed by the laws of England, and is similar in many respects to the MRA. Under the GMRA, the parties enter into Transactions where one party ("Seller") agrees to sell to the other ("Buyer") Securities against the payment of the Purchase Price by Buyer to Seller, with a simultaneous agreement by Buyer to sell to Seller equivalent Securities at a date certain or on demand against the payment of the Repurchase Price by Seller to Buyer. In addition to these transfers, between the Purchase and Repurchase Dates, paragraph 4 of the GMRA provides for the transfer of margin to eliminate Net Exposure under the GMRA, the repricing of designated Transactions to eliminate exposure under those Transactions, and the adjustment of designated Transactions to eliminate exposure under those Transactions. Under paragraph 5, Buyer is obligated to pay to Seller sums equal to income it receives on the Securities. Paragraph 8 allows for the substitution of Securities in certain circumstances. Under paragraph 10 of the GMRA, on the occurrence of an Event of Default,[17] the GMRA is Closed-Out and a Settlement Amount is determined by the non-Defaulting Party.

C. The Master Securities Loan Agreement

The MSLA is governed by the laws of the State of New York. Under the MSLA, the parties enter into Loans in which one party ("Lender") lends to the other party ("Borrower") securities (the "Loaned Securities") against a pledge of Collateral. In addition to these transfers, under Section 8 of the MSLA, the Loans and the Collateral are marked to market, and Collateral is required to be transferred to or from Lender accordingly. Section 3 of the MSLA provides for substitution of Collateral in certain circumstances. Under Section 4, Borrower is obligated to pay Lender a Loan Fee on each Loan to the extent it is secured with Collateral other than cash and Lender is obligated to pay Borrower a Cash Collateral Fee on all cash collateral. Under Section 7, Borrower is entitled to distributions made on non-cash Collateral, and Lender is entitled to distributions made on the Loaned Securities. Under Section 11 of the MSLA, on the occurrence of a Default, the nondefaulting party may terminate all Loans under the MSLA,[18] and under Sections 12 and 13, the nondefaulting party is entitled to liquidate Collateral or Loaned Securities, purchase replacement Collateral or Loaned Securities, and calculate a Settlement Amount due under the MSLA in respect of all of the Loans and the Collateral.

[16] The declaration of an Event of Default is deemed to have been made immediately upon the occurrence of an Act of Insolvency.

[17] In general, the non-Defaulting Party is required to give notice for an Event of Default to occur, although no notice is required in the case of certain insolvency events.

[18] The right to terminate is deemed to have been exercised immediately upon the occurrence of an Act of Insolvency.

D. The Master Securities Forward Transaction Agreement

The MSFTA is governed by the laws of the State of New York. Under the MSFTA, the parties enter into transactions for the purchase and sale of Securities under terms which may call for delayed delivery of the Securities. In addition to these transfers, under an Annex to the MSFTA, the parties can provide for the pledge and transfer of cash or U.S. Treasury securities as Forward Collateral for the payment and performance of all obligations under the MSFTA and the marking-to-market of such Forward Collateral. The Annex also provides for income on the Forward Collateral to be paid to the pledgor thereof and allows for substitution in certain circumstances. Under Paragraph 7 of the MSFTA, on the occurrence of an Event of Default, the nondefaulting party may declare an Event of Default to have occurred, Close Out any and all Transactions under the MSFTA and determine a Settlement Amount due in respect thereof and the Forward Collateral.[19]

E. The Master Dealer Agreement

The MDA is governed by the laws of the State of New York. Under the MDA, the parties enter into Option Contracts on specified U.S. Treasury Securities. In addition to transfers to settle the Option Contracts, the parties enter into an Annex (Performance Assurance Provisions) under which they are required to deliver and pledge cash, U.S. Treasury bills, or other agreed performance assurance to secure the performance of their obligations as writers of Option Contracts. The Annex provides mark-to-market provisions, payment of income on the performance assurance and substitution of performance assurance in certain circumstances. Under paragraph IV of the MDA, on the occurrence of an Event of Default, the Non-Defaulting Party has the right to Close Out one or more Option Contracts, liquidate performance assurance and determine a Settlement Amount due from one party to the other in respect thereof.

III. The Enforceability in Insolvency of Termination, Netting and Foreclosure Provisions and the Avoidance of Transfers under Each Principal Agreement

The Code, the FDIA and SIPA each contain provisions that generally prevent creditors from terminating contracts with the debtor, generally prevent creditors from immediately exercising setoff rights or foreclosing on collateral,[20] generally allow the debtor's trustee, receiver or conservator to choose to perform on some contracts and reject others,[21] and generally allow the debtor's trustee, receiver or conservator to avoid certain transfers made by the debtor.[22] Many of these provisions, if applicable, could impair the Closing-Out Party's

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[19] The declaration of an Event of Default is deemed to have been made immediately upon the occurrence of an Act of Insolvency.

[20] See, e.g., Code § 362 (the filing of a petition under the Code or an application under SIPA operates as an automatic stay) and Code § 365(e) ("ipso facto" clauses invalid).

[21] See, e.g., Code § 365 (trustee's power to assume or reject executory contracts); 12 U.S.C. § 1821(e) (FDIC as conservator or receiver has authority to repudiate or enforce contracts); 12 U.S.C. § 1821(d)(2)(G)(i)(II) (FDIC as conservator or receiver has power to selectively transfer assets and liabilities).

[22] See, e.g., Code §§ 544 (trustee has power to avoid fraudulent transfers under state law), 547 (avoidable preferences), 548 (fraudulent transfers), 553 (avoidance of pre-petition setoffs and of acquisition of rights of setoff);

termination, netting and foreclosure rights under the TBMA Agreements or could allow the debtor's trustee, receiver or conservator to avoid transfers made in accordance with the TBMA Agreements.

The Code and the FDIA each have exceptions to these provisions, and representatives of the Securities Investor Protection Corporation ("SIPC") have issued guidance as to some of these provisions.[23]

A. The Code

The Code protects certain parties to certain contracts from some of the effects discussed above. Section 559 of the Code protects the "contractual right"[24] of a "repo participant"[25] to cause the liquidation of a "repurchase agreement"[26] on the occurrence of events of insolvency, providing that the exercise of that right

> shall not be stayed, avoided, or otherwise limited by operation of any provision of this title or by order of a court or administrative agency in any proceeding under this title, unless, where the debtor is a stockbroker or securities clearing agency, such order is authorized under the provisions of the Securities Investor Protection Act of 1970 or any statute administered by the Securities and Exchange Commission.

Sections 555, 556 and 560 of the Code provide similar protections for "securities contracts,"[27]

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12 U.S.C. §§ 1821(c)(2)(B) and (c)(3)(B) (generally giving FDIC as conservator or receiver the powers of conservators and receivers under other law); 12 U.S.C. § 91 (receiver for national bank has ability to avoid certain preferences).

[23] As noted above, pending legislation, if enacted, would substantially broaden the protections under the Code and the FDIA (as well as FDICIA), and would codify the SIPC guidance into statutory form.

[24] "Contractual right" is defined to include "a right set forth in a rule or bylaw, applicable to each party to the repurchase agreement, of a national securities exchange, a national securities association, or a securities clearing agency, and a right, whether or not evidenced in writing, arising under common law, under law merchant or by reason of normal business practice." Code § 559.

[25] "Repo participant" is defined as any "entity that, on any day during the period beginning 90 days before the date of the filing of the petition, has an outstanding repurchase agreement with the debtor." Code § 101(46).

[26] "Repurchase agreement" is defined as "an agreement, including related terms, which provides for the transfer of certificates of deposit, eligible bankers' acceptances, or securities that are direct obligations of, or that are fully guaranteed as to principal and interest by, the United States or any agency of the United States against the transfer of funds by the transferee of such certificates of deposit, eligible bankers' acceptances, or securities with a simultaneous agreement by such transferee to transfer to the transferor thereof certificates of deposit, eligible bankers' acceptances, or securities as described above, at a date certain not later than one year after such transfers or on demand, against the transfer of funds." Code § 101(47).

[27] "Securities contract" is defined as "contract for the purchase, sale, or loan of a security, including an option for the purchase or sale of a security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any option entered into on a national securities exchange relating to foreign currencies, or the guarantee of any settlement of cash or securities by or to a securities clearing agency." Code § 741(7).

"commodity contracts,"[28] "forward contracts",[29]and "swap agreements,"[30] for counterparties that are "stockbrokers,"[31] "financial institutions,"[32] "securities clearing agencies,"[33] "commodity brokers,"[34] "forward contract merchants"[35] or "swap participants,"[36] respectively.

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28 "Commodity contract" is defined as "(A) with respect to a futures commission merchant, contract for the purchase or sale of a commodity for future delivery on, or subject to the rules of, a contract market or board of trade; (B) with respect to a foreign futures commission merchant, foreign future; (C) with respect to a leverage transaction merchant, leverage transaction; (D) with respect to a clearing organization, contract for the purchase or sale of a commodity for future delivery on, or subject to the rules of, a contract market or board of trade that is cleared by such clearing organization, or commodity option traded on, or subject to the rules of, a contract market or board of trade that is cleared by such clearing organization; or (E) with respect to a commodity options dealer, commodity option." Code § 761(4).

29 "Forward contract" is defined as "a contract (other than a commodity contract) for the purchase, sale, or transfer of a commodity … or any similar good, article, service, right, or interest which is presently or in the future becomes the subject of dealing in the forward contract trade, or product or byproduct thereof, with a maturity date more than two days after the date the contract is entered into, including, but not limited to, a repurchase transaction, reverse repurchase transaction, consignment, lease, swap, hedge transaction, deposit, loan, option, allocated transaction, unallocated transaction, or any combination thereof or option thereon." Code § 101(25).

30 "Swap agreement" is defined as " (A) an agreement (including terms and conditions incorporated by reference therein) which is a rate swap agreement, basis swap, forward rate agreement, commodity swap, interest rate option, forward foreign exchange agreement, spot foreign exchange agreement, rate cap agreement, rate floor agreement, rate collar agreement, currency swap agreement, cross-currency rate swap agreement, currency option, any other similar agreement (including any option to enter into any of the foregoing); (B) any combination of the foregoing; or (C) a master agreement for any of the foregoing together with all supplements." Code § 101(53B).

31 "Stockbroker" is defined as a "person (A) with respect to which there is a customer (as defined in section 741 of [the Code]); and (B) that is engaged in the business of effecting transactions in securities (i) for the account of others; or (ii) with members of the general public, from or for such person's own account." Code § 101(53A).

32 "Financial institution" is defined as a "person that is a commercial or savings bank, industrial savings bank, savings and loan association, or trust company and, when any such person is acting as agent or custodian for a customer in connection with a securities contract, as defined in section 741 of [the Code], such customer." Code § 101(22).

33 "Securities clearing agency" is defined as a "person that is registered as a clearing agency under section 17A of the Securities Exchange Act of 1934, or whose business is confined to the performance of functions of a clearing agency with respect to exempted securities, as defined in section 3(a)(12) of such Act for the purposes of such section 17A." Code § 101(48).

34 "Commodity broker" is defined as a "futures commission merchant, foreign futures commission merchant, clearing organization, leverage transaction merchant, or commodity options dealer, as defined in Section 761 of [the Code], with respect to which there is a customer, as defined in Section 761 of [the Code]." Code § 101(6).

35 "Forward contract merchant" is defined as a "person whose business consists in whole or in part of entering into forward contracts as or with merchants in a commodity, as defined in Section 761(8) of [the Code], or any similar good, article, service, right, or interest which is presently or in the future becomes the subject of dealing in the forward contract trade." Code § 101(26).

36 "Swap participant" is defined as an "entity that, at any time before the filing of the petition, has an outstanding swap agreement with the debtor." Code § 101(53C).

Under Section 362(b)(7) of the Code, the automatic stay upon the filing of a petition under the Code or an application under SIPA does not apply to:

> the setoff by a repo participant, of any mutual debt and claim under or in connection with repurchase agreements that constitutes the setoff of a claim against the debtor for a margin payment[37] … or settlement payment[38] … arising out of repurchase agreements against cash, securities, or other property held by or due from such repo participant to margin, guarantee, secure or settle repurchase agreements.

Section 362(b)(6)[39] and (17)[40] provide similar protection for claims for "margin" and "settlement payments" under commodity contracts, forward contracts, and securities contracts and for "payments" under swap agreements. Section 553(b) of the Code cross-refers to Sections 362(b)(6), (7) and (17),[41] in providing protections against the avoidance of preferential pre-petition setoffs in connection with commodity contracts, forward contracts, securities contracts, repurchase agreements and swap agreements.

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[37] "Margin payment" is defined for purposes of Section 362(b)(7) as a "payment or deposit of cash, a security, or other property, that is commonly known to the securities trade as original margin, initial margin, maintenance margin, or variation margin, or as a mark-to-market payment, or that secures an obligation of a participant in a securities clearing agency" and as a "payment or deposit of cash, a security, or other property, that is commonly known to the commodities trade as original margin, initial margin, maintenance margin, or variation margin, including mark-to-market payments, settlement payments, variation payments, daily settlement payments, and final settlement payments made as adjustments to settlement prices." Code §§ 741(5) and 761(15). In addition, "margin payment" is defined for purposes of Section 362(b)(6) of the Code as a "payment or deposit of cash, a security or other property, that is commonly known in the forward contract trade as original margin, initial margin, maintenance margin, or variation margin, including mark-to-market payments, or variation payments". Code § 101(38).

[38] "Settlement payment" is defined for purposes of Section 362 (b)(7) as a "preliminary settlement payment, a partial settlement payment, an interim settlement payment, a settlement payment on account, a final settlement payment, or any other similar payment commonly used in the securities trade." Code § 741(8). In addition, "settlement payment" is defined for purposes of Section 362(b)(6) of the Code as a "preliminary settlement payment, a partial settlement payment, an interim settlement payment, a settlement payment on account, a final settlement payment, a net settlement payment, or any other similar payment commonly used in the forward contract trade." Code § 101(51A).

[39] Section 362(b)(6) protects from the automatic stay "the setoff by a commodity broker, forward contract merchant, stockbroker, financial institutions, or securities clearing agency of any mutual debt and claim under or in connection with commodity contracts … forward contracts, or securities contracts … that constitutes the setoff of a claim against the debtor for a margin payment … or settlement payment … arising out of commodity contracts, forward contracts, or securities contracts against cash, securities, or other property held by or due from such commodity broker, forward contract merchant, stockbroker, financial institutions, or securities clearing agency to margin, guarantee, secure, or settle commodity contracts, forward contracts, or securities contracts."

[40] Section 362(b)(17) protects from the automatic stay "the setoff by a swap participant, of any mutual debt and claim under or in connection with any swap agreement that constitutes the setoff of a claim against the debtor for any payment due from the debtor under or in connection with any swap agreement against any payment due to the debtor from the swap participant under or in connection with any swap agreement or against cash, securities, or other property of the debtor held by or due from such swap participant to guarantee, secure or settle any swap agreement."

[41] Section 553(b) contains a typographical error, referring to Section 362(b)(14) (the predecessor to Section 362(b)(17)), rather than to Section 362(b)(17).

The protections afforded by Sections 555, 556, 559, 560, 362(b)(6), 362(b)(7), 362(b)(17) and 553(b) of the Code depend on the characteristics of the creditor and debtor, the type of claims, the classification of the contract, and the relationship between the contract and the claims being set off. As described above, the CPMA does not as a structural matter generally affect the termination, netting and foreclosure provisions of the Principal Agreements; the CPMA only amends the TBMA Agreements to add additional events of default, to change notice requirements, and to provide that, once a Settlement Amount is determined under the TBMA Agreement, the Settlement Amount is not paid immediately but netted against other Settlement Amounts until the Final Settlement Date. These amendments affect neither the characteristics of the creditor or debtor nor the classification of the TBMA Agreements.[42] Furthermore, since the CPMA does not change the TBMA Agreements' process of Closing-Out and determining a Settlement Amount, the CPMA does not affect the relationship between the TBMA Agreements and the claims being set off in the determination of Settlement Amounts. Thus neither entry into the CPMA nor the provision of a Section 2 Notice would adversely affect the protections otherwise given to rights to terminate, net, set off and foreclose under the TBMA Agreements by Sections 555, 556, 559, 560, 362(b)(6), 362(b)(7) and 362(b)(17) or the protections otherwise given against avoidance of pre-petition setoffs under the TBMA Agreements under Section 553(b) of the Code.

Section 546(f) of the Code provides protections from the trustee's avoidance powers for certain transfers in connection with repurchase agreements:

> [T]he trustee may not avoid a transfer that is a margin payment … or settlement payment … made by or to a repo participant, in connection with a repurchase agreement and that is made before the commencement of the case, except under section 548(a)(1)(A) of this title.

Similar protections are contained in Section 546(e) for prepetition margin or settlement payments made by or to a commodity broker, forward contract merchant, stockbroker, financial institution or securities clearing agency and in Section 546(g) for prepetition transfers[43] made under a swap agreement, by or to a swap participant, in connection with a swap agreement. Section 548(a)(1)(A), which is carved out of the protections in Sections 546(e), (f), and (g), allows the trustee to avoid transfers made with actual intent to hinder, delay, or defraud creditors. Under Section 548(d)(2)(B), however, a commodity broker, forward contract merchant, stockbroker, financial institution, securities clearing agency or repo participant that receives a margin payment or settlement payment, or a swap participant that receives a transfer, is deemed to take

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[42] If a TBMA Agreement is classified in one of the categories defined above, then amending the TBMA Agreement to add events of default, change notice provisions, and provide that a Settlement Amount determined under the TBMA Agreement will be set off against Settlement Amounts determined under other TBMA Agreements does not cause the TBMA Agreement to be classified in a different category.

[43] "Transfer" is defined in the Code as "every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with property or with an interest in property, including retention of title as a security interest and foreclosure of the debtor's equity of redemption." Code § 101(54).

for value to the extent of such payment or transfer and therefore may retain such payment or transfer, notwithstanding the debtor's actual fraudulent intent, if it acted in good faith.[44]

Neither entry into the CPMA nor the provision of a Section 2 Notice would affect the status of a transfer as a margin payment or settlement payment, alter the classification of the creditor, the debtor or the TBMA Agreement, or change the connection between a transfer and the TBMA Agreement, so neither would adversely affect the protections Sections 546(e), (f), and (g) and 548(d)(2) of the Code otherwise provide to transfers under the TBMA Agreements.

B. SIPA

Sections 555 and 559 of the Code except orders authorized under SIPA from the protections they otherwise provide to contractual rights to liquidate "securities contracts" and "repurchase agreements". Representatives of SIPC have stated in correspondence with the TBMA and others that, although SIPC's standard form of stay order that it proposes to the court will bar the immediate close-out of repurchase agreements and certain securities lending transactions, such order will allow close-outs upon receipt of written consent of SIPC and the trustee. The correspondence sets forth parameters for SIPC's performance of the repurchase agreements and securities lending transactions or for SIPC's consent to close-outs (including, in certain cases, receipt of an affidavit of the counterparty attesting that the counterparty has no knowledge of any fraud involved in the transaction and that it has a perfected security interest in the underlying securities).[45] Like the protections under the Code, the applicability of these letters depends on the characteristics of the creditor and debtor, the type of claims and the classification of the contracts. Again, neither entry into the CPMA nor the provision of a Section 2 Notice would affect these factors. Thus, neither entry into the CPMA nor the provision of a Section 2 Notice would adversely affect the protections otherwise afforded to counterparties to the TBMA Agreements by the SIPC correspondence.

C. The FDIA

The FDIA provides a number of protections to counterparties to "qualified financial contracts" ("QFCs"), which are defined as "any securities contract, commodity contract, forward contract, repurchase agreement, swap agreement, and any similar agreement

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[44] Code § 548(c).

[45] See Letter from Michael E. Don, SIPC Deputy General Counsel, to Robert A. Portnoy, Deputy Executive Director and General Counsel of the Public Securities Association, dated February 4, 1986 (repurchase agreements); Letter from Michael E. Don to J. Eugene Marans, Cleary, Gottlieb, Steen & Hamilton, dated August 29, 1988 (securities lending transactions); Letter from Michael E. Don to James D. McLaughlin, Director, American Bankers Association, dated October 30, 1990 (securities lending transactions secured by cash collateral or supported by letters of credit); Letter from Michael E. Don to John G. Macfarlane, III, Chairman, Repo Committee, Public Securities Association, dated February 19, 1991 (securities lending transactions secured by cash collateral or supported by letters of credit); Letter from Michael E. Don, SIPC President, to Seth Grosshandler, Cleary, Gottlieb, Steen & Hamilton, dated February 14, 1996 (repurchase agreements falling outside the Code definition of "repurchase agreement").

that the [FDIC] determines by regulation to be a qualified financial contract...."[46] Under 12 U.S.C. § 1821(e)(8)(A),

> [s]ubject to paragraph (10) of this subsection[47] and notwithstanding any other provision of this chapter (other than subsection (d)(9) of this section and section 1823(e) of this title), [48] any other Federal law, or the law of any State, no person shall be stayed or prohibited from exercising -
>
> (i) any right to cause the termination or liquidation of any qualified financial contract with an insured depository institution which arises upon the appointment of the [FDIC] as receiver for such institution at any time after such appointment;
>
> (ii) any right under any security arrangement relating to any contract or agreement described in clause (i); or
>
> (iii) any right to offset or net out any termination value, payment amount, or other transfer obligation arising under or in connection with 1 or more contracts and agreements described in clause (i), including any master agreement for such contracts or agreements.[49]

Furthermore, 12 U.S.C. § 1821(e)(9) protects parties to QFCs by requiring the conservator or receiver to either transfer to a single depository institution all QFCs between the depository institution in default and any person or affiliate of that person, along with all unsubordinated claims under those contracts and property securing those contracts or claims, or transfer none of them at all. Finally, 12 U.S.C. § 1821(e)(8)(C) protects transfers under QFCs from avoidance as preferences or fraudulent transfers in certain circumstances. Like the protections under the

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[46] 12 U.S.C. § 1821(e)(8)(D)(i). The FDIA refers to the Code for most of the constituent definitions, but broadens some of them. See 12 U.S.C. § 1821(e)(8)(D).

[47] 12 U.S.C. § 1821(e)(10) provides that the FDIC as conservator or receiver must provide notice of a transfer of QFCs to a successor institution by noon on the business day following such transfer. The FDIC has interpreted §§ 1821(e)(8) and 1821(e)(10) to mean that a counterparty to a QFC cannot exercise remedial rights if such QFC, all other QFCs between such counterparty, its affiliates and the failed depository institution, and all unsubordinated claims under, and property securing, such QFCs have been transferred to a successor institution and the FDIC has given the counterparty notice of such transfer by the close of business (New York time) on the business day following its appointment as receiver. FDIC Policy Statement on Qualified Financial Contracts, 55 Fed. Reg. 7027 (1990).

[48] These sections generally provide that any agreement which tends to diminish the FDIC's interest in an asset is not valid against the FDIC unless it "(A) is in writing, (B) was executed by the depository institution and any person claiming an adverse interest thereunder, including the obligor, contemporaneously with the acquisition of the asset by the depository institution, (C) was approved by the board of directors of the depository institution or its loan committee, which approval shall be reflected in the minutes of said board or committee, and (D) has been, continuously, from the time of its execution, an official record of the depository institution." 12 U.S.C. § 1823(e). The FDIC has issued a policy statement relaxing the "written agreement" requirements in the case of QFCs. FDIC Policy Statement on Qualified Financial Contracts, 55 Fed. Reg. 7027 (1990).

[49] 12 U.S.C. § 1821(e)(8)(E) contains a similar provision regarding conservatorship that protects a counterparty's rights in the event of a performance default under a QFC.

Code, these protections depend on the classification of the contracts (although not on the classification of the creditor). Since neither entry into the CPMA nor the provision of a Section 2 Notice would affect the classification of a TBMA Agreement as a QFC, neither would adversely affect the protections otherwise afforded to counterparties to the TBMA Agreements by 12 U.S.C. §§ 1821(e)(8) and (9).

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