Update No. 96-1,
Repo Trading Practices Guidelines

At the request of a significant number of members of The Bond Market Association active in the repurchase transaction markets, the Trading Practices Committee of the Association's Funding Division is publishing an optional substitution/termination provision (see below) to The Bond Market Association's Master Repurchase Agreement. The optional provision is intended to document substitution/termination language that allows the transferor (i.e., Repo Seller) to retain effective control over the transferred asset (i.e., Purchased Securities) or to elect to terminate the repurchase transaction prior to maturity (i.e., Repurchase Date) on short notice to the transferee (i.e., Repo Buyer).

Paragraph 9 (a) of the Master Repurchase Agreement (both the 1987 and 1996 versions) currently provides that the parties to a Repurchase Transaction can agree that the transferor (i.e., Repo Seller) has substitution rights. Parties may, of course, choose to enter into oral agreements with each other providing for rights of substitution, based on the advice of their legal counsel as to the enforceability of such oral agreements. Nevertheless, some market participants desired a model document provision that both provides for that right and prescribes a predetermined methodology for quantifying the economic loss suffered by the transferee (i.e., Repo Buyer) as a direct consequence of the transferor's (i.e., Repo Seller's) exercise of its substitution/termination right. In that regard, the optional provision is intended to make the transferee (i.e., Repo Buyer) economically "whole". In other words, although the transferor would maintain effective control over the specific asset transferred in connection with the repurchase transaction, the transferee would not suffer economically because the loss provision is intended to place the transferee in the same position it would have been had the transferor not effectuated that control through the exercise of the substitution/termination right.

The optional provision contains a short time frame for notice of substitution. The provision reflects the current Restated Repo Trading Practices Guidelines (Paragraph M.3.), by providing that notice of substitution should be provided by 10:00 am (New York time) for substitutions to occur on the same business day, and if notice of substitution is given after 10 am (New York time), substitution would occur on the next business day.

The Trading Practices Committee views such period as the minimal time frame necessary to effectuate the exercise of the contractual right and determine the appropriate dollar amount consistent with the contractual "make whole" provision. Parties may agree on different notice periods. The Trading Practices Committee makes no recommendation as to the contractual form through which market participants may choose to utilize the optional provision. Some participants may choose to include this provision in Annex I as a Supplemental Term and Condition of the Master Repurchase Agreement, whereas others may choose to include the provision in its written confirmations of repurchase agreement transactions. Moreover, as indicated above, certain market participants may choose to orally agree on the terms otherwise documented in the optional provision. The Association recommends that market participants consult with their legal advisors concerning the desirability or contractual form of use of this optional provision with respect to its firm's particular needs and circumstances.

Optional Substitution Provision

(a) In the case of any Transaction for which the Repurchase Date is other than the business day immediately following the Purchase Date and with respect to which Seller does not have any existing right to substitute substantially the same Securities for the Purchased Securities, Seller shall have the right, subject to the proviso to this sentence, upon notice to Buyer, which notice shall be given at or prior to 10 am (New York time) on such business day, to substitute substantially the same Securities for any Purchased Securities; provided, however, that Buyer may elect, by the close of business on the business day notice is received, or by the close of the next business day if notice is given after 10 am (New York time) on such day, not to accept such substitution. In the event such substitution is accepted by Buyer, such substitution shall be made by Seller's transfer to Buyer of such other Securities and Buyer's transfer to Seller of such Purchased Securities, and after substitution, the substituted Securities shall be deemed to be Purchased Securities. In the event Buyer elects not to accept such substitution, Buyer shall offer Seller the right to terminate the Transaction.

(b) In the event Seller exercises its right to substitute or terminate under sub-paragraph (a), Seller shall be obligated to pay to Buyer, by the close of the business day of such substitution or termination, as the case may be, an amount equal to (A) Buyer's actual cost (including all fees, expenses and commissions) of (i) entering into replacement transactions; (ii) entering into or terminating hedge transactions; and/or (iii) terminating transactions or substituting securities in like transactions with third parties in connection with or as a result of such substitution or termination, and (B) to the extent Buyer determines not to enter into replacement transactions, the loss incurred by Buyer directly arising or resulting from such substitution or termination. The foregoing amounts shall be solely determined and calculated by Buyer in good faith.