Guidance Notes to the Master Securities Forward Transaction Agreement

December 2012 Version

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The Securities Industry and Financial Markets Association (the "Association") has prepared a revised version of its Master Securities Forward Transaction Agreement (the "Master Agreement"). The Master Agreement was first published in July 1996 to provide a basic contractual framework for forward and other delayed delivery transactions involving mortgage-backed and asset-backed securities.

This revision of the Master Agreement has been prepared in order to update the agreement throughout and assist market participants in complying with a recommendation from the Treasury Market Practices Group (the "TMPG") that:

> **Consistent with prudent management of counterparty exposures, forward-settling transactions, such as agency MBS transactions, should be margined.** To help both parties mitigate counterparty risk owing to market value changes, two-way variation margin should be exchanged on a regular basis. Written master agreements should describe the parties' agreement on all aspects of the margining regime, including collateral eligibility, timing and frequency of margin calls and exchanges, thresholds, valuation of exposures and collateral, and liquidation.[1]

In consultation with participants from all sides of the forward transaction market, the Association has revised the Master Agreement to include two-way margining as an integral part of the Master Agreement and to specify or streamline the parties' agreement upon the essential elements of a margining regime identified by the TMPG.

The Master Agreement continues to offer the parties substantial flexibility, through the use of Annexes, to structure their relationship beyond this basic framework. For example, the parties may elect to broaden the scope of the Master Agreement to cover other types of securities (including non-U.S. securities) or modify certain terms based on internal credit considerations.

The Master Agreement provides, on a reciprocal basis, the basic legal protections that are essential for forward transaction market participants, including two-way margining, default remedies and standard provisions for delivery of and payment for securities covered by the Master Agreement. The default remedies are intended to bolster those remedies that a party may have under common law or otherwise (*e.g.*, through provisions contained in confirmations). The Master Agreement has also been revised and updated in various ways, including to make it clear that, after terminating transactions as a result of an Event of Default, the nondefaulting party may be liable to the defaulting party.

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[1] TMPG, "TMPG Recommends Margining of Agency MBS Transactions to Reduce Counterparty and Systemic Risks" (Nov. 14, 2012).

The Master Agreement has been drafted and revised with an eye to the following principles—

> **Reciprocity.** The Master Agreement as drafted is a bilateral document, with identical rights and obligations attaching to each party, whether acting as Buyer, Seller, or both. This reciprocity should increase the comfort of parties with the Master Agreement's provisions. The parties may wish, however, to provide for certain provisions, particularly credit-related provisions, to apply to only one of the parties. This may be accomplished through the use of the Annexes.
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> **Standardization of Frequently Negotiated Provisions.** The Master Agreement has been revised to anticipate negotiation over terms relating to margining (*e.g.*, Additional Margin Amounts, Thresholds, Minimum Transfer Amounts, Eligible Forward Collateral and Margin Percentages) and Events of Default (*e.g.*, grace periods for certain Events of Default and whether a failure to deliver Securities on a Settlement Date is an Event of Default) and provides (in the form of Annex I) standard language that parties can use to document their agreement on these terms. In addition, an Annex III has been prepared for use in Transactions where a party is acting as agent for one or more disclosed principals.

The Master Agreement has been prepared as a standard form and any person proposing to use it should ascertain that it is suitable for the circumstances in which it is proposed to be used. The Association does not assume responsibility for use of the Master Agreement or any Annex in any particular circumstance. Parties using this documentation may wish to incorporate amendments. The Association, however, will only permit this documentation to be used in an amended form if the amendments are made in such a way that they are clearly identifiable, *e.g.*, through provisions in Annex I, through the use of a supplement or in a mark-up of the printed form.

To assist users of the Master Agreement, the Association has prepared the following guidance notes that explain and summarize the provisions of the Master Agreement, as revised, on a section-by-section basis. ***These guidance notes should not be relied upon by any party to determine, without appropriate legal, accounting or other relevant professional advice, whether the Master Agreement is suitable to its particular circumstances and needs.*** Capitalized terms not otherwise defined have the meanings given to them in the Master Agreement.

Paragraph 1: Applicability

> Paragraph 1 delineates the general scope and applicability of the Master Agreement. The Master Agreement applies to all transactions between the parties for the purchase and sale of "Securities" pursuant to delayed delivery transactions. "Securities" is defined as mortgage-backed and other asset-backed securities, as well as any other types of securities the parties specify in Annex I. Parties could also use Annex I to exclude certain types of securities from the scope of the Master Agreement (*e.g.*, securities that are not "government securities" as defined in the Securities Exchange Act of 1934). Delayed delivery transactions include not only forward purchase and sale transactions, but also when-issued, TBA, and dollar roll transactions involving Securities. Each such transaction is referred to in the Master Agreement as a "Transaction."

Parties entering into Transactions under the Master Agreement on assets other than U.S. mortgage-backed and asset-backed securities should carefully review the Master Agreement to determine whether supplemental provisions are necessary to accommodate those Transactions. Parties should consider in particular the treatment of forward transactions involving assets other than securities in the event of a counterparty insolvency under the U.S. Bankruptcy Code or other applicable insolvency regimes, as well as any additional tax, accounting or other regulatory consequences.

The Master Agreement does not address issues that may arise in Transactions on non-U.S. securities or involving non-U.S. parties. Among the legal and other considerations that may need to be taken into account in cross-border or non-U.S. transactions are the means of transfer that are to be used for non-U.S. securities (which may have important operational and creditors' rights implications), considerations arising under non-U.S. insolvency or other laws that may be applicable to a counterparty, and tax considerations. These issues generally can be addressed fully only with knowledge of the specific non-U.S. securities and specific non-U.S. counterparties involved in a transaction and thus would be difficult to resolve in a master agreement that is intended to serve as a basic framework for a wide range of securities transactions.

This Paragraph also contains the language providing an opportunity for the parties to establish supplemental terms and conditions in Annex I or other Annexes. Although it is not anticipated that supplemental terms and conditions would be desirable in every case, some parties may, as noted above, find it useful to specify certain business aspects of their relationship or include particular provisions required by relevant regulatory authorities.

This Paragraph has been revised to provide expressly that, in the event of any inconsistency between the body of the Master Agreement and any Annex, the terms of the Annex will govern.

Paragraph 2: Definitions

The definitions in Paragraph 2 cover the principal recurring terms used in subsequent portions of the Master Agreement. The following terms have been added to Paragraph 2 in connection with the incorporation of two-way margining into the Master Agreement and are addressed in the discussion below of Paragraph 4: Additional Margin Amount, Close of Business, Current Margin Amount, Eligible Forward Collateral, Excess Forward Collateral Amount, Forward Exposure, In-the-Money Party, Margin Percentage, Margin Value, Market Value, Minimum Transfer Amount, Net Forward Exposure, Net Unsecured Forward Exposure, Out-of-the-Money Party, and Threshold Amount.

Act of Insolvency

In the July 1996 version, the language of this definition mirrors that in the Association's Master Repurchase Agreement (July 1996 version), and encompasses those events typically considered to be clear indications of a party's inability to perform. It has been revised to expressly include an administrator for the party or a substantial part of its property among the officials whose appointment constitutes an Act of Insolvency. The occurrence of an Act of Insolvency is an Event of Default.

Business Day

The definition of Business Day reflects the applicability of the Master Agreement to mortgage-backed and asset-backed securities. Parties that expand the Master Agreement through Annex I to cover additional types of Securities should consider whether the definition of Business Day is appropriate for those types of Securities.

Buyer and Seller

Unless otherwise provided in Annex I, a party may act as Buyer, Seller, or both under the Master Agreement.

Collateral and Forward Collateral; Pledgor and Pledgee; Secured Obligation

When a party ("Pledgor") pledges "Forward Collateral" to the other party ("Pledgee") pursuant to Paragraph 4, then it also pledges other property in the Pledgee's possession or control in connection with the Master Agreement or any Transaction (together with the Forward Collateral, the "Collateral"). This revised definition is more limited than the definition in the July 1996 version, where "Collateral" included all property in Pledgee's possession or control, whether or not there was a connection to the Master Agreement or a Transaction. The Collateral secures payment and performance of all obligations of Pledgor to Pledgee under the Master Agreement (the "Secured Obligations"). Paragraph 7 of the Master Agreement gives the Pledgee remedies upon an Event of Default in respect of all Collateral.

Event of Default

The occurrence of an Event of Default is the condition precedent to a nondefaulting party's exercise of remedies under Paragraph 7. The revisions moved this definition into Paragraph 2 from Paragraph 4, revised several elements to the definition and provided for a simplified and standardized method for agreement upon grace periods for the various Events of Default. The Master Agreement now specifies nine Events of Default, which can be summarized as:

(i) a failure to pay on Settlement Date;

(ii) a failure by a party that is failing to deliver a Security on the Settlement Date to repay, in accordance with Paragraph 8(i), any portion of a purchase price received from the other party;

(iii) a failure to deliver Securities on a Settlement Date, but only if the parties have indicated in Annex I that this is an Event of Default;

(iv) a failure to perform any covenant or obligation under Paragraph 4 (Margin Maintenance);

(v) a failure by a party that is failing to deliver a Security on the Settlement Date to deliver in accordance with Paragraph 8(ii) Forward Collateral to cover the other party's exposure with respect to failure;

(vi) a failure by a party that has failed to deliver a Security on the Settlement Date to pay in accordance with Paragraph 8(iii) an amount due as a result of the other party's termination of that Transaction;

(vii) the occurrence of an Act of Insolvency;

(viii) the making of a false representation; and

(ix) the admission by an officer (or a person reasonably believed to be an officer) of a party of its inability to, or intention not to, perform its obligations under the Master Agreement.

The parties may add events to these standard Events of Default in Annex I.

As in the July 1996 version, the revised Master Agreement does not provide for prior notice or any cure period; however, the definition of "Event of Default" in the revised Master Agreement has been designed to make it very easy for parties who wish to apply cure periods to do so by simply specifying the length of the cure period in Annex I.

In a departure from the July 1996 version, clause (iii) of the definition of Event of Default provides that a failure to deliver securities on the Settlement Date will constitute an Event of Default <u>only if</u> the parties indicate in Annex I that clause (iii) will apply. If the parties do not indicate in Annex I that clause (iii) of the definition of "Event of Default" shall apply, then a Buyer's remedies when Seller fails to deliver on the Settlement will be limited to those specified in the new Paragraph 8 (Mini Close-out). Events of Default have also been added for a Seller's failure to pay or deliver Forward Collateral as required by such Paragraph 8.

The Event of Default relating to a party's admission of its inability to, or intention not to, perform has been revised so that it expressly requires the admission to come from an officer (or person reasonably believed to be an officer) of the party making the admission.

Prime Rate

This rate is used in subparagraph 7(e) for the accrual of interest on amounts owing by a defaulting party.

Settlement Date and Trade Date

These definitions are used in the Master Agreement in setting forth when the parties are deemed to repeat certain representations, when certain Events of Default are triggered and when the Margin Maintenance provisions of Paragraph 4 require the delivery or return of Forward Collateral.

Paragraph 3: Initiation and Confirmation

Paragraph 3 describes the mechanics of initiating and confirming a Transaction. The Master Agreement contemplates that either party may initiate a Transaction orally or in writing and that one or both parties (depending typically on whether the Transaction is between a dealer and a customer or between two dealers) shall deliver a Confirmation of the Transaction.

The Confirmation may be delivered in writing or as otherwise agreed in accordance with market practice. This formulation is designed to allow flexibility in adapting to technological and regulatory developments, and, in particular, to allow for electronic Confirmations.

A Confirmation, together with the Agreement, constitutes *prima facie* evidence of the Transaction terms agreed between the parties, unless specific objection is made promptly after receipt of the Confirmation. (This is a change from the July 1996 version, under which a Confirmation that is not objected to promptly constitutes *conclusive* evidence of the Transaction terms.)

Parties may wish to specify in Annex I who will be confirming Transactions, what information should be set forth in the Confirmation and how "promptly" objection to a Confirmation must be made. In addition, if both parties will be confirming Transactions, they may find it useful to establish a rule of precedence to govern occasions in which their respective Confirmations contain inconsistent terms.

The Master Agreement has been revised to provide that the Master Agreement will prevail in the event of any conflict between the terms of a Confirmation and the Master Agreement, unless the Confirmation has been executed by both parties. A Confirmation that has been executed by both parties will prevail over conflicting terms in the Master Agreement. As a matter of good practice, Confirmations should only address the terms of the Transactions to which they relate; generally applicable modifications to the Master Agreement should be made in Annex I or an amendment to the Master Agreement.

Paragraph 4: Margin Maintenance

The July 1996 version of the Master Agreement did not integrate mark-to-market provisions into the agreement; instead, it provided two versions of an optional Annex III. The first version, the "Mark-to-Market Provisions," provided mark-to-market provisions that required each party to provide collateral to cover the other's exposure, while the second version, the "Alternative Mark-to-Market Provisions," required collateralization of only one party's exposure and allowed any exposure the other party had to be uncollateralized.

The Master Agreement has been revised to integrate mark-to-market provisions into Paragraph 4 of the Master Agreement in a way that is largely based on the first version of Annex III to the 1996 version. Under Paragraph 4, a party is entitled to call for margin whenever the margin it already holds is not sufficient to cover the net loss (if any) it would incur upon cancellation of the Transactions and entry into replacement transactions.

The mark-to-market process is as follows:

First, each party determines for each Transaction the amount of loss (if any) each would incur upon canceling such Transaction and entering into a replacement transaction. These amounts, each party's "Forward Exposure" for each Transaction, are to be determined by reference to the price or bid quotation for the replacement transaction obtained from a generally recognized source agreed to by the parties. Forward Exposures are only positive amounts; if a party would not incur a loss by canceling and replacing a Transaction (including if such party would experience a gain upon cancellation and replacement), such party's Forward Exposure with respect to that Transaction would be zero.

Second, each party's "Net Forward Exposure" is determined by adding up that party's Forward Exposures with respect to all Transactions, and subtracting the sum of the other party's Forward Exposures with respect to all Transactions. Net Forward Exposure is determined without regard to any Forward Exposure under any Transaction whose Settlement Date has occurred. (See the discussion of Paragraph 8(ii) for margining Forward Exposure under Transactions that remain outstanding after their Settlement Dates because Seller fails to deliver the relevant Securities.)

Third, the amount of Forward Collateral each party is entitled to receive (such party's "Current Margin Amount") is calculated. In the simplest case, a party's Current Margin Amount is any positive Net Forward Exposure that the party may have. The revised Master Agreement, however, also allows the parties to agree upon:

- an amount or amounts of Forward Collateral that a party may be required to provide in addition to that required to cover the other party's Net Forward Exposure (such amount or sum of amounts, such party's "Additional Margin Amount"); and/or

- a "Threshold" amount of uncollateralized exposure that must exist before a party is required to transfer Forward Collateral.

Each party's Additional Margin Amount or Threshold is zero unless the parties agree to a different amount.

To take proper account of Additional Margin Amounts and Thresholds, a party's "Current Margin Amount" is defined as the excess, if any, of (i) the sum of such party's Net Forward Exposure and the other party's Additional Margin Amount *over* (ii) the sum of such party's Additional Margin Amount and the other party's Threshold. Like Forward Exposure, this amount cannot be negative; a party that is not entitled to receive any Forward Collateral has a Current Margin Amount of zero.

Fourth, each party's Current Margin Amount is compared to the amount of Forward Collateral that has been transferred to such party (and not returned) to determine whether that party is entitled to hold more or less Forward Collateral than it currently has.

- If a party's Current Margin Amount exceeds the amount of Forward Collateral such party has already received (and not returned), then such excess is a "Net Unsecured Forward

Exposure." When a party has a Net Unsecured Forward Exposure in excess of any "Minimum Transfer Amount" agreed to be applicable to transfers by the other party, the party with such Net Unsecured Forward Exposure (the "In-the-Money Party") has a right under subparagraph 4(a) to deliver a notice to the other party (the "Out-of-the-Money Party") requiring delivery of Eligible Forward Collateral sufficient to eliminate such Net Unsecured Forward Exposure.

- If the amount of Forward Collateral a party has already received (and not returned) exceeds such party's Current Margin Amount, then such excess is an "Excess Forward Collateral Amount" and represents an obligation to return Forward Collateral. When a party has an Excess Forward Collateral Amount that exceeds any "Minimum Transfer Amount" agreed to be applicable to such party, the other party has a right under subparagraph 4(b) to deliver a notice requiring such party to return Forward Collateral sufficient to eliminate such Excess Forward Collateral Amount.

For this purpose, Forward Collateral is valued at its Margin Value. The "Margin Value" of an item of Forward Collateral is its Market Value, divided by a "Margin Percentage" agreed between the parties with respect to such Forward Collateral. Margin Percentages are generally 100% or more, and the Margin Value of an item of Forward Collateral would be no more than its Market Value. Sometimes the difference between the Market Value and Margin Value of Forward Collateral is called a "haircut," so agreement upon a "haircut" h for an item of Forward Collateral is the same as agreeing to a Margin Percentage of $1/(1-h)$. In the absence of an agreement on a Margin Percentage for an item of Forward Collateral (other than U.S. dollar cash, which has a 100% Margin Percentage), the In-the-Money Party determines its Margin Percentage.

For purposes of determining the Margin Value of a security, its "Market Value" is obtained from a generally recognized source agreed to by the parties, including accrued principal and/or interest (unless contrary to market practice).

An Out-of-the-Money Party with a collateral delivery obligation must deliver U.S. dollar cash, U.S. Treasury securities, or other securities acceptable to the In-the-Money Party ("Eligible Forward Collateral").

Subparagraph 4(c) incorporates a margin notice deadline (10:00 a.m. New York time on a Business Day) for same-day satisfaction of margin maintenance obligations in connection with Transactions. If a margin call is made by the margin notice deadline, the party receiving a notice of a margin call must satisfy its margin maintenance obligation by the close of the Fedwire Funds Service (the "Close of Business") on such Business Day. If the margin notice deadline is not met, the party receiving such notice has until the Close of Business on the next Business Day to satisfy its margin maintenance obligation.

Although the Master Agreement does not state that the parties may agree to calculate and transfer margin on a Transaction-by-Transaction basis, rather than on a net basis across all Transactions (as was stated in subparagraph 2(e) of Annex III to the July 1996 version), there is nothing in the Master Agreement that would prevent the parties from agreeing (in Annex I or otherwise) to calculate and deliver margin separately with respect to each Transaction (or with respect to separate groups of Transactions).

Under subparagraph 4(d), any party ("Pledgor") obligated to provide Forward Collateral under the Master Agreement grants to the other party ("Pledgee") a first priority security interest in and right of setoff against that Forward Collateral and all securities, money and other property delivered by or on behalf of Pledgor to or for the benefit of Pledgee in connection with the Master Agreement or any Transaction, or held or carried by or on behalf of Pledgee in connection with the Master Agreement or any Transaction, and all proceeds thereof (the "Collateral") to secure all obligations of Pledgor under the Master Agreement (the "Secured Obligations").

Subparagraph 4(d) entitles the Pledgee of Collateral to repledge or otherwise use any and all Collateral, but expressly states that such repledge or use does not relieve the Pledgee of its obligation to transfer Collateral to Pledgor pursuant to the terms of the Master Agreement.

A Pledgor of Forward Collateral may, subject to agreement with and acceptance by the Pledgee, substitute other Eligible Collateral for any Forward Collateral.

Paragraph 5: Payment and Transfer; Market Practice

Paragraph 5 sets forth the manner in which securities and funds are to be transferred. Unless otherwise agreed, each Transaction is to be settled on a delivery-versus-payment basis, and Securities are to be transferred in suitable form for transfer, over the book-entry system of a Federal Reserve Bank or any other mutually agreeable method. Parties may wish to provide delivery instructions in Annex I or Annex II to the Master Agreement.

This Paragraph also requires each party to conform to market practice for a particular type of Transaction, including the provisions of the Uniform Practices for the Clearance and Settlement of Mortgage-Backed Securities and Other Related Securities, provided that such market practice does not conflict with any express terms of any Transaction as agreed between the parties thereto.

Although not mentioned in the Agreement, where both parties are members of the Mortgage-Backed Securities Division of the Fixed Income Clearing Corporation (the "MBSD"), transactions submitted by them will become subject to the rules of the MBSD, including with respect to margining, settlement and remedies, and the terms of the Master Agreement applicable to those Transactions will be superseded by those rules. Among other things, this means that, in accordance with market practice, Transactions submitted by the parties to the MBSD should not be included in the calculation of Net Forward Exposure for purposes of Paragraph 4.

Paragraph 6: Representations

The Master Agreement contains standard trade documentation representations, which are deemed repeated on each date the parties enter into a Transaction. Each party represents that (i) it is authorized to execute the Master Agreement and enter into Transactions, (ii) it will engage in Transactions as principal (unless otherwise agreed in writing), (iii) its signatory is authorized to act on its behalf, (iv) it has obtained all governmental authorization and (v) execution and performance of the Master Agreement and Transactions do not violate the law.

Paragraph 7: Events of Default

The default provisions of subparagraph 7(a) give the nondefaulting party the option to declare an Event of Default. The nondefaulting party is required to give notice as promptly as practicable of its option to declare an Event of Default, but such notice does not need to precede the exercise of remedies under Paragraph 7 and the inability to give such notice (*e.g.*, as a result of a failure by the defaulting party to answer its telephones or maintain other lines of communication) will not preclude the immediate exercise of the nondefaulting party's rights. While this option is automatically deemed to be exercised immediately upon an Act of Insolvency under the July 1996 version of the Master Agreement, the revised Master Agreement allows the non-defaulting party to elect whether to exercise this option, even upon the occurrence of an Act of Insolvency. (As discussed below, subparagraph 2(d) of the form of Annex I to the Master Agreement provides optional language that the parties could use to make the exercise of this option automatic upon, or immediately before, certain Acts of Insolvency.) Under both the July 1996 version and as revised, the notice requirement does not apply upon the occurrence of an Act of Insolvency.

Under subparagraph 7(a), the nondefaulting party may on or promptly following the date on which the Event of Default is declared, (i) close out all Transactions under the Master Agreement and determine its losses, costs and/or gains that are or would be incurred upon in replacing all Transactions and (ii) sell in a recognized market (or otherwise in a commercially reasonable manner) any noncash Collateral and apply the proceeds to the obligations of the defaulting party under the Master Agreement or, in its sole discretion, elect to give the defaulting party credit for any such Collateral.

The nondefaulting party may not "cherry pick" which Transactions it will close out. It must terminate all or none of its Transactions with the defaulting party. The nondefaulting party may determine the cost of replacement transactions whether or not it actually enters into any, and includes the cost of terminating any hedges related to the Transactions. Costs include all fees, expenses and commissions.

Subparagraph 7(b) addresses the situation where the defaulting party is the pledgee of Collateral, and requires the defaulting party to transfer any Collateral held by it to the nondefaulting party upon an Event of Default. On or promptly following the date on which an Event of Default is declared, the nondefaulting party may purchase replacements for any securities Collateral is not so transferred or in its sole discretion elect to be deemed to have purchased such Replacement Securities. The price for such Replacement Securities, together with the amount of any cash Collateral not delivered by the defaulting party to the nondefaulting party is included in the nondefaulting party's losses and costs as a result of the Event of Default.

Subparagraph 7(d) provides that the defaulting party is liable to the nondefaulting party for reasonable legal or other expenses incurred by the nondefaulting party in connection with an Event of Default, damages equal to the price of any Replacement Securities purchased (or deemed purchased) by the nondefaulting party, the amount of any cash Collateral not returned by the defaulting party, the cost (including fees, expenses and commissions) of entering into replacement transactions and entering into or terminating hedge transactions, and any other loss, damage, cost or expense directly arising or resulting from the occurrence of an Event of Default in respect of a Transaction regardless of whether the nondefaulting party enters into or terminates, as the case may be, any such replacement or hedge transaction. The nondefaulting party may set off any obligations to the defaulting party against any of the defaulting party's obligations under the Master Agreement.

Unlike the July 1996 version of the Master Agreement, subparagraph 7(d) also expressly provides that the nondefaulting party is obligated to pay to the defaulting party any net gains in replacing Transactions, so long as the defaulting party provides an acceptable release of liability under or relating to the Master Agreement.

Subparagraph 7(d) provides for default interest at the Prime Rate on all amounts owed by the defaulting party.

Subparagraph 7(f) provides that, unless otherwise agreed by the parties, any securities included in the Collateral are instruments traded in a "recognized market" and that, in the absence of a generally recognized source for prices or bid or offer quotations for any Security, the nondefaulting party is entitled in its sole discretion to establish the source therefor. It also provides that all prices, bids and offers shall be determined together with accrued principal and/or interest thereon, except to the extent contrary to market practice with respect to the relevant securities.

Subparagraph 7(g) serves to accord the nondefaulting party all the rights and remedies provided to a secured party under the New York Uniform Commercial Code (whether or not the NYUCC would otherwise be applicable) and any other rights under any other applicable law or agreements.

Finally, subparagraph 7(h) requires the nondefaulting party to act in good faith and "use commercially reasonable procedures in order to produce a commercially reasonable result". "Commercially reasonable procedures" may include, among other things, obtaining prices from (i) generally recognized pricing sources, (ii) firm or indicative bids or offers from third parties active in the relevant market or (iii) pricing or valuation methodologies from internal sources (including affiliates) if the nondefaulting party uses those methodologies in the regular course of its business in pricing or valuing the relevant Securities or Transactions.

Paragraph 8: Mini Close-out

Paragraph 8, which did not appear in the July 1996 version of the Master Agreement, allows Buyer, in the event of Seller's failure to deliver Securities as due on the Settlement Date, to exercise remedies only with respect to the Transaction related to the failure, without declaring an Event of Default and terminating all Transactions between the parties. Specifically, Buyer may require Seller to repay any amount Buyer paid to Seller in respect of the Transaction and transfer Eligible Forward Collateral to eliminate any exposure Buyer has to Seller with respect to that Transaction (without regard to either party's Net Forward Exposure with respect to any other Transaction). In addition, Buyer may elect to terminate the failing Transaction (after the relevant grace period, if any, has elapsed). The provisions of Paragraph 7 (Event of Default) would apply to such Transaction as if an Event of Default had been declared solely with respect that Transaction.

If parties elect to have clause (iii) of the definition of "Event of Default" (Seller's failure to deliver Securities on a Settlement Date) apply, Buyer may also elect to declare an Event of Default upon Seller's failure to deliver Securities. Its rights under Paragraph 8 would be in addition to, not in lieu of, its right to declare an Event of Default for such failure. The parties may make this election in Annex I.

Failure by Seller to comply with its obligations under Paragraph 8 is itself an Event of Default.

Paragraph 9: Setoff

Subparagraph 9(a) provides that the parties may set off certain payment or delivery obligations between them. Payment obligations may be set off against one another if both parties owe a payment in the same currency on the same day, resulting in the payment of a net amount. Delivery obligations may be set off against one another if both parties owe a delivery of the same Securities or TBA Securities with the same specifications, resulting in the delivery of a net quantity of Securities. Unlike subparagraph 9(b), subparagraph 9(a) applies whether or not an Event of Default has occurred.

Subparagraph 9(b) provides a nondefaulting party the right to set off amounts it owes against amounts that the defaulting party owes to the nondefaulting party under any other agreement between the parties. The nondefaulting party may set off obligations even if they are unmatured or contingent, and even if they are denominated in a different currency than the nondefaulting party's obligation. If the obligation is unliquidated or contingent, the nondefaulting party may estimate the obligation in good faith if it provides an accounting to the defaulting party once the obligation is ascertained. If the defaulting party's obligations are denominated in a different currency than the nondefaulting party's obligations, the nondefaulting party may convert one obligation into the currency of the other at an exchange rate it determines in good faith with commercially reasonable procedures.

Paragraph 10: Single Agreement

This paragraph clarifies that all Transactions the parties enter into under the Master Agreement constitute a single business and contractual relationship. Thus, the parties may set off claims and net payments, deliveries and other transfers in respect of any one Transaction against all other Transactions under the Master Agreement.

Paragraph 11: Risk of Loss

This paragraph sets forth in general terms the risk of loss of engaging in when-issued, TBA, dollar roll and other transactions that result or may result in the delayed delivery of securities, and that, before engaging in Transactions, each party should consult its own business, legal, tax and accounting advisers with respect to the proposed Transaction and examine the contractual arrangements contained in the Master Agreement carefully to determine all risks and whether the Transaction is appropriate for that party. It is intended that neither party to the Master Agreement will be relying on the advice of the other, that each party will have made its own decisions regarding entering into Transactions under the Master Agreement and that each party understands the risks, terms and conditions of each Transaction. To this end, each party agrees that the other party is not acting as a fiduciary or an advisor to it in respect of the Master Agreement or any Transaction; parties may wish to consider supplemental provisions in Annex I to the Master Agreement in this regard.

Paragraph 12: Notices and Other Communication

It is intended in Paragraph 12 that notices will generally be effective upon receipt, with standard exceptions used by market participants covering circumstances in which a notice is received by a party on a day that is not a Business Day or in which the sender of the notice uses reasonable efforts to provide notice but is unable to prove receipt.

Because telegrams are no longer in use by very many market participants, the revision has deleted telegraph from the list of permissible means of giving notice.

The revision has also added a consent by both parties to the recording by the other of telephone conversations between them.

Paragraph 13: Entire Agreement; Severability

Paragraph 13 establishes that the Master Agreement generally supersedes any existing agreements between the parties containing general terms for when-issued, TBS, dollar roll and other transactions that result or may result in the delayed delivery of Securities.

Paragraph 14: Nonassignability; Termination

Assignment of the Agreement or any Transaction under the Agreement is not permitted without the prior written consent of the non-assigning party. Although the Master Agreement may be terminated upon written notice, the Master Agreement remains applicable to any outstanding Transactions.

Paragraph 15: Governing Law; Submission to Jurisdiction; Waiver of Immunity; Jury Trial Waiver

Subparagraph 15(a), as revised, clarifies that, although New York law governs the Master Agreement, New York choice of law provisions should generally not apply *if it would result in the application of the substantive law of another jurisdiction*. This provision is designed to ensure that New York substantive law always applies. It is also intended to confirm the applicability of New York General Obligation Law § 5-1401, which allows any contract covering a transaction worth $250,000 or more to provide for the application of New York law and is arguably a "choice of law" provision.

The choice of New York law is based upon a determination that, among the jurisdictions in the United States, the greatest number of securities forward transactions occur within New York. New York also has an extensive body of commercial and securities law and New York General Obligations Law, § 5-1401 provides market participants with certainty regarding applicable law.

New subparagraph 15(b) is a submission to the exclusive jurisdiction of U.S. federal and New York state courts sitting in Manhattan and waiver of any *forum non conveniens* or similar defense.

In new subparagraphs 15(c) and (d) the parties waive any sovereign or other immunity they may have and waive any right they may have to a trial by jury in any proceeding involving, directly or indirectly, any matter arising out of, related to, or connected with, the Master Agreement.

Paragraph 16: No Waivers, Etc.

Paragraph 16 contains a standard provision that a waiver of any Event of Default does not constitute a waiver of any other Event of Default. The waiver of any provision of the Master Agreement must be in writing and executed by both parties.

Paragraph 17: Use of Employee Plan Assets

This Paragraph contains only those provisions that the Association views as essential in light of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). Because there are a variety of prohibited transactions and exemptions therefrom that might apply if a party (a "Plan Party") intends to use assets of an employment benefit plan subject to ERISA, depending on the exact nature of the delayed-delivery transaction being entered into, the Association does not feel that more specific provisions are useful in this general Master Agreement. Some parties may find the inclusion of additional provisions relating to ERISA desirable under some circumstances and are invited to include any such provisions in Annex I. This Paragraph has been revised to allow the parties more flexibility to determine the scope of the appropriate representations from the Plan Party. As under the July 1996 version, a party who has received representations from a Plan Party is not obligated to proceed with any Transaction in reliance in those representations.

Paragraph 18: Intent

This Paragraph confirms the parties' understanding that the Transactions are eligible for "safe harbors" from certain provisions of various U.S. insolvency laws. It has been updated to reflect changes in the U.S. insolvency laws since 1996, including the adoption of the Orderly Liquidation Authority provisions of Title II of Dodd-Frank.

Annex I: Supplemental Terms and Conditions

The Annexes to the Master Agreement are formatted in a manner similar to most Annexes to other Association agreements, namely, they do not contain signature lines and they contain blank spaces at the beginning in which to insert the names of the parties and the date of the agreement. Parties should consider whether they also wish to require separate signatures on each Annex, in particular to help prove, as an evidentiary matter, that a particular party has entered into a particular Annex. Even if not all Annexes are signed, the parties may wish to sign Annex I, which has been drafted to permit the parties to designate the Annexes that will apply to Transactions under the Master Agreement.

Annex I would also include the identification of securities other than mortgage-backed and asset-backed securities that constitute "Securities" under the Master Agreement, and any provisions relating to Transactions involving such Securities, such as specific provisions for settlement, taxes (in the case of international securities or cross-border transactions) and the like.

Parties can also use Annex I to agree upon optional terms in the Master Agreement, or to modify or supplement the Master Agreement. The form of Annex I to the revised Master Agreement includes, in Paragraphs 2 through 4, standard language that parties may use for some frequently negotiated provisions of the Master Agreement.

Parties may use the language provided in subparagraph 2(a) of the form of Annex I if they wish to include cure periods for one or more potential Events of Default. (If the parties do not specify a cure period in Annex I, no cure period will exist, and the occurrence of the relevant event will immediately give rise to the nondefaulting party's right to exercise remedies.) Parties may elect to have such a cure period commence upon notice of the applicable failure by including the relevant bracketed language or immediately upon the applicable failure by omitting it.

Parties may use the language provided in subparagraph 2(b) of the form of Annex I to have clause (iii) of the definition of "Event of Default" apply. Clause (iii) provides that Seller's failure to deliver required Securities on a Settlement Date is an Event of Default, but only if the parties elect for it to apply in Annex I. If the parties do not affirmatively indicate Annex I that clause (iii) applies, Buyer's remedies for Seller's failure to deliver will be limited to those provided in Paragraph 8 (Mini Close-out).

Parties may elect to include the language provided in subparagraph 2(c) of the form of Annex I to make the provisions of Paragraph 7 apply only when the "Event of Default" is still continuing. This optional provision is intended to provide counterparties standard language clarifying that if a party cures an undeclared "Event of Default," the other party no longer has grounds to declare a default. However, if a party has declared a default prior to any such cure, nothing in this provision is intended to prevent the nondefaulting party from the full exercise of its remedies under Paragraph 7.

Subparagraph 2(d) of the form of Annex I provides language that the parties can use to provide for "automatic early termination" upon an Act of Insolvency. This provision would deem the nondefaulting party to have declared an Event of Default immediately upon certain Acts of Insolvency and immediately before the institution of an insolvency proceeding in respect of the defaulting party. The automatic stays of certain jurisdictions' insolvency law require automatic early termination to fully protect the nondefaulting party's right to exercise remedies. Parties should seek advice from counsel in the relevant jurisdiction to determine whether "automatic early termination" would enhance their right to exercise remedies if their counterparty defaults.

Parties may use the language provided in Paragraph 3 of the form of Annex I to allow the parties to set the Additional Margin Amount, Minimum Transfer Amount and Threshold Amount and assign the categories of Eligible Forward Collateral (each discussed above in "Paragraph 4: Margin Maintenance").

Parties may use the language provided in Paragraph 4 of the form of Annex I to require Forward Collateral delivered by or on behalf of investment companies registered under the Investment Company Act of 1940 to be segregated with a custodian and prohibit its sale, repledge, rehypothecation or other transfer by the Pledgee prior to the occurrence of an Event of Default by the Pledgor.

Annex II: Names and Addresses for Communication Between the Parties

This Annex provides for the parties to list the names and addresses to be used for all notices, statements, demands or other communications between the parties. The parties may wish to provide in Annex I for additional instructions for wire transactions or other deliveries.

Annex III: Party Acting as Agent

Annex III adapts the terms of the Master Agreement to govern agency Transactions. Annex III addresses a number of practical and legal issues in this context. The central objective of Annex III is to assist parties entering into Transactions in determining who, as between the Agent and its Principal(s), is liable for performance under the Master Agreement. It was modeled after an Annex to the Master Securities Loan Agreement (1993 version) covering agency securities loan transactions, which also formed the basis for a similar Annex to the Master Repurchase Agreement (1996 version).

Paragraphs 1 and 2 require the party acting as Agent to disclose the identity of the Principal(s) for whom it intends to act as Agent and to represent and warrant that each such Principal has authorized it to execute and deliver the Master Agreement, to enter into the Transactions and to perform the obligations of the Principal(s) thereunder.

Paragraph 3 sets forth general rules limiting the Agent's liability under the Master Agreement. Where the Agent has, through compliance with the provisions of the Master Agreement, taken the steps necessary to permit the other party to the Master Agreement to assess the creditworthiness of its Principal(s), the Agent's obligations do not include a guarantee of performance by its Principal(s) and the other party's remedies do not include a right of setoff with respect to any obligations between the Agent, acting for its own account, and the other party.

Paragraph 4 provides that when an Agent acts on behalf of multiple Principals, the Master Agreement presumes that the Transactions will be treated as multiple Transactions on behalf of separate Principals, unless the parties agree in writing to treat the Transactions as if they were

Transactions by a single Principal. This Paragraph also sets forth the rights and obligations of the Agent with respect to each situation.

Paragraph 5 sets forth a general rule of construction for the terms “party,” “parties,” “Seller” and “Buyer,” as the case may be, in the Master Agreement in the context of agency Transactions, subject to the limitation of an Agent’s liability in Paragraph 3 of Annex III. This Paragraph explicitly acknowledges that each Principal has the rights, responsibilities, privileges and obligations of a “party” that enters directly into Transactions with another party, and that the Agent has been designated as the sole agent of each Principal for performance of such party’s obligations to the other party, and for receipt of performance by the other party in connection with the Transactions. The terms “party” and “either party” are generally deemed to refer to both the Agent and the Principal(s), including inter alia, in the context of a default. The effect of that this construction of the terms “party” and “parties” is that a bankruptcy or similar default by the Agent will also be deemed a default by the Principal(s). Under the revised Master Agreement, “non-custodial advisors” are not deemed parties to the Master Agreement, with the effect that an Act of Insolvency or other Event of Default with respect to a non-custodial advisor would not constitute an Event of Default under the Master Agreement. This exclusion is based on a conclusion that when all deliveries and payments are made directly to the Principal (or its custodian), the other party does not have material credit or other exposures to the non-custodial advisor.