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13 July 2006

Mr Gopal Sundaram
Bank Negara Malaysia
Jalan Dato' Onn
P.O. Box 10922
50929 Kuala Lumpur
Malaysia

Dear Gopal –

Re: Close-out Netting in Malaysia

We are writing to you on behalf of the International Swaps and Derivatives Association, Inc. (“ISDA”). With apologies for the delay in submitting this letter, we herewith wish to follow up with you and your respective colleagues on our constructive dialogue in late March where we discussed the status of close-out netting in Malaysia.

As you are aware, ISDA, which represents participants in the privately negotiated derivatives industry, is the largest global financial trade association, by number of member firms. ISDA was chartered in 1985, and today has more than 725 member institutions from 50 countries on six continents. These members include most of the world's major institutions that deal in privately negotiated derivatives, as well as many of the businesses, governmental entities and other end users that rely on over-the-counter derivatives to efficiently manage the risks inherent in their core economic activities.

Overview

1. At the 28 March 2006 meeting we suggested that in order for Malaysia to be classified as a netting jurisdiction without material qualifications, parts of the Pengurusan Danaharta Nasional Berhad Act 1998 (“Danaharta Act”) and the Malaysia Deposit Insurance Corporation Act 2005 (“Deposit Insurance Corporation Act”) will need to be amended. In our letter of 1 December 2005, we explained the underlying reasons for the amendments.

2. The proposed amendments would comprise:
 - 2.1 The list of financial agreements (the “**Financial Agreements**”) found within Section 80 of the Deposit Insurance Corporation Act should be expanded (the “**Expanded List of Financial Agreements**”) to include all types of derivatives which are presently traded and likely to be traded in the future as well as to extend the definition of Financial Agreements to include collateral agreements such as the ISDA Credit Support Annexes, ISDA Credit Support Deed or ISDA Margin Provisions (the “**First Amendment**”); and
 - 2.2 A carve-out by way of the “**Second Amendment**” of the expanded definition of Financial Agreements from the ambit of the **moratorium** provisions in:
 - (a) Section 41(1)(d) of the Danaharta Act¹; and
 - (b) Section 27 of the Deposit Insurance Corporation Act.
3. These moratorium provisions apply when in the case of the Danaharta Act, a ‘special administrator’² is appointed or in the case of the Deposit Insurance Corporation Act, a ‘conservator’³ is appointed. Both appointments immediately trigger the statutory moratorium, which precludes the operation of close-out netting.

The First Amendment

4. ISDA understands that the First Amendment can be enacted through a relatively straightforward process of issuing regulations pursuant to Section 80(h) of the Deposit Insurance Corporation Act. We are advised that the Deposit Insurance Corporation Act itself provides the procedure to be adhered to in the issuing of such regulations⁴.
5. As you are aware, Section 80(h) of the Deposit Insurance Corporation Act gives the Malaysian Deposit Insurance Corporation the power to make regulations, to add further types of agreements or transactions. In order to exercise this power, the Corporation requires the approval of the Minister of Finance.
6. We enclose a suggested set of regulations in draft, purely for purposes of discussion. Please see Annex A, which includes a list of additional agreements

¹ Despite the winding down of the Danaharta Corporation, the moratorium provisions of the Danaharta Act have not been repealed and thus remain a technical legal hurdle to full netting recognition for Malaysia.

² Under the Danaharta Act.

³ Under the Deposit Insurance Corporation Act.

⁴ Section 100 of the Deposit Insurance Corporation Act sets out the relevant procedure.

that ISDA proposes to be inserted as Financial Agreements under Section 80(h) of the Deposit Insurance Corporation Act.

7. If the Malaysian Deposit Insurance Corporation is prepared to accede to these proposed changes and the Minister of Finance approves of the proposed regulations, these regulations made under Section 80(h) of the Deposit Insurance Corporation Act would thereafter be published in the Official Gazette of the Federation (the “**Gazette**”) and laid before the Dewan Rakyat as soon as possible after publication⁵.
8. ISDA is advised that once promulgated, the regulations will take effect either on the date specified in the said regulations, or if no date is provided, on the date of the publication of such regulations in the Gazette.

The Second Amendment

The Danaharta Act

9. We are advised that section 41(1) of the Danaharta Act applies where a Special Administrator is appointed in relation to an “affected person”. The affected person may have earlier entered into an ISDA Master Agreement with a counterparty containing provisions for close-out netting. We understand that upon becoming subject to the appointment of a Special Administrator, a moratorium of 12 months duration (which may be extended) comes into effect. Pursuant to sub-section (1)(d) of section 41 to the Danaharta Act, no counterparty can set-off any debt due from it to the affected person against a claim due to the counterparty by the affected person. Therefore, close out netting will not be possible under an ISDA Master Agreement in such a situation.
10. ISDA believes there is a potential solution to this, which it would like to explore (in line with the approach taken under the Deposit Insurance Corporation Act). We note that Section 80 of the Deposit Insurance Corporation Act excludes certain Financial Agreements from the scope and application of Section 76 of the Deposit Insurance Corporation Act. By this carve-out, for those Financial Agreements, termination and close-out netting can consequently take place unaffected notwithstanding the application of section 76 of the Deposit Insurance Corporation Act.
11. ISDA believes that an amendment can be made to the Danaharta Act to insert a new provision (“**New Danaharta Provision**”) that is similar in effect and operation to section 80 of the Deposit Insurance Corporation Act. ISDA proposes that the New Danaharta Provision should carve-out the Expanded List of Financial Agreements from the ambit of section 41(1)(d) of the Danaharta Act.

⁵ Section 100(4) of the Deposit Insurance Corporation Act.

12. We understand that this carve-out can be given effect by amending the said section 41(1)(d) of the Danaharta Act by the passing of an Amending Act of Parliament. ISDA will be pleased to offer any assistance it can to Bank Negara, Danaharta Corporation or its successor Prokhas Sdn Bhd and the Drafting Division of the Malaysian Attorney-General's Chambers in relation to the wording of any New Danaharta Provision. ISDA suggests the following, or any variation thereof that ultimately achieves the intended effect and which will operate in tandem with an expanded list of agreements:

“Nothing in section 41(1)(d) shall prevent the termination of any of the following agreements or transactions in accordance with their terms or the netting or setting off of an amount payable in respect of such agreements or transactions including...”

Deposit Insurance Corporation Act

13. A similar solution needs to be explored in relation to the Deposit Insurance Corporation Act, where, as you are aware, section 27 states that where a Conservator is appointed in relation to an “affected person” (who may have earlier entered into, for example, an ISDA Master Agreement with a counterparty, with provisions for close-out netting), a moratorium of 12 months duration (which may be extended) comes into effect and pursuant to paragraph 17(1)(e)(iv) of the Third Schedule to the Deposit Insurance Corporation Act, no counterparty can set-off any debt due from it to the affected person against a claim due to the counterparty by the affected person. Therefore, close-out netting under such an ISDA Master Agreement will also not be possible in such situations, much in the same manner as under the Danaharta Act as explained above.
14. ISDA proposes that an amendment be made to the Deposit Insurance Corporation Act to insert a new provision (“**New DIC Provision**”) to carve-out from the ambit of paragraph 17(1)(e)(iv) of the Third Schedule certain types of agreement where the ability to close-out and terminate is preserved, in the same manner envisaged by Section 80 of the Deposit Insurance Corporation Act.
15. We understand that this carve-out can be given effect by amending the said Section 27 of the Deposit Insurance Corporation Act and/or paragraph 17(1)(e) of the Third Schedule by passing an Amending Act of Parliament.
16. ISDA will be pleased to offer any assistance it can to Bank Negara, the Malaysian Deposit Insurance Corporation and the Drafting Division of the Malaysian Attorney-General's Chambers in relation to the wording or any New DIC Provision. ISDA proposes the following New DIC Provision for consideration by all concerned and which will operate in tandem with the Expanded List of Financial Agreements:

“Nothing in section 27 read together with paragraph 17(1)(e)(iv) of the Third Schedule shall prevent the termination of any of the following agreements or transactions in accordance with their terms or the netting or setting off of an amount payable in respect of such agreements or transactions including...”

Conclusion

17. ISDA assures you of its total cooperation and assistance in achieving these changes to the legislation described above. We hope that these proposed changes to the legislation will pave the way for Malaysia to qualify as a close-out netting jurisdiction without qualifications. As a first step, we particularly wish to pursue the First Amendment, as per Annex A, and we look forward to further discussing the proposed approach with Bank Negara Malaysia.
18. It may be helpful to be aware, that the need for resolution of the above issues are not unique to Malaysia, but that ISDA worked closely with authorities on similar matters in a number of jurisdictions, including the United States. For example, the safe harbors for OTC derivative transactions were expanded and clarified in the United States Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 so that close-out netting for those financial contracts was protected. Those protected financial contracts continue, in turn, to be exempt from the automatic stay provisions in the United States Bankruptcy Code.
19. ISDA much appreciates Bank Negara Malaysia’s interest in seeing this issue resolved in order to provide legal and regulatory certainty to derivative market participants. Once again, ISDA expresses its gratitude for being able to assist and comment on close-out netting in Malaysia.
20. Please do not hesitate to contact either Ms Angela Papesch (+65 6538 3879), Ms Jacqueline Low (+65 6328 5920) or Mr Rabindra Nathan (+603 20762812) if you require any further information on this matter, or any clarification of the issues set out above.

With very best regards,



Jacqueline Low
Co-Chair of ISDA’s Asia-Pacific
Legal & Regulatory Committee



Angela Papesch
Director of Policy &
Head of ISDA’s Asia-Pacific Office

MALAYSIA DEPOSIT INSURANCE CORPORATION ACT 2005

MALAYSIA DEPOSIT INSURANCE CORPORATION
(FINANCIAL AGREEMENTS) REGULATIONS 2006

In exercise of the powers conferred by subsection 80(h) and section 100 of the Malaysia Deposit Insurance Corporation Act 2005 [*Act 642*], the Corporation, with the approval of the Minister, makes the following Regulations:

Citation and commencement

1. (1) These Regulations may be cited as the **Malaysia Deposit Insurance Corporation (Financial Agreements) Regulations 2006**.
- (2) These Regulations come into operation on [] 2006.

Interpretation

2. In these Regulations, unless the context otherwise requires-

“collateral” means any of the following:

- (i) cash in any currency;
- (ii) securities of any kind, including (without limitation) debt and equity securities;
- (iii) guarantees, letters of credit and obligations to reimburse; and
- (iv) any asset commonly used as collateral in Malaysia;

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

- (i) a pledge or any other form of security interest in collateral, whether possessory or non possessory;
- (ii) a title transfer collateral arrangement; and
- (iii) any guarantee, letter of credit or reimbursement obligation by or to a party to one or more qualified financial contracts, in respect of those qualified financial contracts;

“netting” means the occurrence of any or all of the following:

- (i) the termination, liquidation and/or acceleration of any payment or delivery obligations or entitlements under one or more qualified financial contracts entered into under a netting agreement;
- (ii) the calculation or estimation of close-out value, market value, liquidation value or replacement value in respect of each obligation or entitlement or group of obligations or entitlements terminated, liquidated and/or accelerated under (i);
- (iii) the conversion of any values calculated or estimated under (ii) into a single currency; and
- (iv) the determination of the net balance of the values calculated under (ii), as converted under (iii), whether by operation of set-off or otherwise;

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

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

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

Prescribed Financial Agreements

3. The following shall be deemed to be prescribed financial agreements or transactions for the purposes of section 80(h) of the Malaysia Deposit Insurance Corporation Act 2005 [*Act 642*].

- (a) a basis swap;
- (b) a cap, collar or floor transaction;
- (c) a forward rate agreement;
- (d) a currency or interest rate future;
- (e) a currency or interest rate option;
- (f) an equity derivative, such as an equity or equity index swap, equity forward, equity option or equity index option;

- (g) a derivative relating to bonds or other debt securities or to a bond or debt security index, such as a bond option, a total return swap, index swap, forward, option or index option;
- (h) a credit derivative, such as a credit default swap, credit default basket swap, total return swap or credit default option;
- (i) an energy derivative, such as an electricity derivative, oil derivative, coal derivative or gas derivative;
- (j) a weather derivative, such as a weather swap or weather option;
- (k) a bandwidth derivative;
- (l) a freight derivative;
- (m) a carbon emissions derivative;
- (n) an inflation derivative;
- (o) a spot, future, forward or other commodity transaction;
- (p) an agreement to buy, sell, borrow or lend securities, such as a securities repurchase or reverse repurchase agreement, a securities lending agreement or a securities buy/sell-back agreement;
- (q) an agreement to buy, sell, borrow or lend bullion or commodities, such as a commodities repurchase or reverse repurchase agreement, a commodities lending agreement or a commodities buy/sell-back agreement;
- (r) a collateral arrangement;
- (s) an agreement to clear or settle securities transactions or to act as a depository for securities;
- (t) any other agreement, contract or transaction similar to any agreement, contract or transaction referred to paragraphs (a) to (s) with respect to one or more reference items or indices relating to (without limitation) interest rates, currencies, commodities, energy products, electricity, equities, weather, bonds and other debt instruments, precious metals, quantitative measures associated with an occurrence, extent of an occurrence, or contingency associated with a financial, commercial or economic consequence, or economic or financial indices or measures of economic or financial risk or value;
- (u) any swap, forward, option, contract for differences or other derivative in respect of, or combination of, one or more agreements or contracts referred to in paragraphs (a) to (t) and in section 80(a) to (d) of the Malaysia Deposit Insurance Corporation Act 2005 [Act 642].

Made [] 2006
[PIDM/PN/ /2006; PN(PU²)]

TAN SRI DATO' ABDUL AZIZ BIN HAJI TAHA
Chairman
Malaysia Deposit Insurance Corporation

[To be laid before the Dewan Rakyat pursuant to subsection 100(4) of the Malaysia Deposit Insurance Corporation Act 2005]