

EFMLG Symposium on Standard Market Documentation

Collateral & Margin Dispute Resolution

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Topics

- Causes of Disputes
- Current status of Market Documentation for resolving disputes
- Issues with current Market Documentation
- Improvements / Harmonisation

Causes of Disputes

- Sources of valuation of securities / dealer polls
- Market disruption
- Counterparty discretion
- Different internal valuation methodologies
- Illiquid trades
- Trade mismatch, booking errors
- Potential defaulting party challenges in order to 'buy time'

Current - Market Documentation



ISDA Credit Support Annex: English Law Paragraph 4. Dispute Resolution

- (a) **Disputed Calculations or Valuations.** If a party (a “Disputing Party”) reasonably disputes (I) the Valuations Agent’s calculation of a Delivery Amount or a Return Amount or (II) the Value of any transfer of Eligible Credit Support or Equivalent Credit Support, then;
- (1) the Disputing Party will notify the other party and the Valuation Agent (if the Valuation Agent is not the other party) not later than the close of business on the Local Business Day following, in the case of (I) above, the date that the demand is received under Paragraph 2 or, in the case of (II) above, the date of transfer;
 - (2) in the case of (I) above, the appropriate party will transfer the undisputed amount to the other party not later than the close of business on the Settlement Day following the date that the demand is received under Paragraph 2;
 - (3) the parties will consult with each other in an attempt to resolve the dispute; and
 - (4) if they fail to resolve the dispute by the Resolution Time, then:
 - (i) in the case of a dispute involving a Delivery Amount or Return Amount, unless otherwise specified in Paragraph 11 (c), the Valuation Agent will recalculate the Exposure and the value as of the Recalculation Date by:
 - (A) utilising any calculations of that part of the Exposure attributable to the Transactions that the parties have agreed are not in dispute;
 - (B) calculating that part of the Exposure attributable to the Transactions in dispute by seeking four actual quotations at mid-market from Reference Market makers for purposes of calculating Market Quotation and taking the arithmetic average of those obtained; *provided* that if four quotations are not available for a particular transaction, then fewer than four quotations may be used for that Transaction and if no quotations are available for a particular Transaction, then the Valuation Agent’s original calculations will be used for the Transaction; and

Credit Support Annex: English Law



Paragraph 4. Dispute Resolution (continued).....

- (C) utilising the procedures specified in Paragraph 11 (e) (ii) for calculating the Value, if disputed, of the outstanding Credit Support Balance;
- (ii) in the case of a dispute involving the Value of any transfer of Eligible Credit Support or Equivalent Credit Support, the Valuation Agent will recalculate the Value as of the date of transfer pursuant to Paragraph 11 (e) (ii)

Following a recalculation pursuant to this Paragraph, the Valuation Agent will notify each party (or the other party, if the Valuation Agent is a party) as soon as possible but in any event not later than the Notification Time on the Local Business Day following the Resolution Time. The appropriate party will, upon demand following such notice given the Valuation Agent or a resolution pursuant to (3) above and subject to Paragraph 3 (a), make the appropriate transfer.

(b) **No Event of Default.** The failure by a party to make a transfer of any amount which is the subject of a dispute to which Paragraph 4 (a) applies will not constitute an Event of Default for as long as the procedures set out in this Paragraph 4 are being carried out. For the avoidance of doubt, upon completion of those procedures, Section 5 (a) (i) of this Agreement will apply to any failure by a party to make a transfer required under the final sentence of Paragraph 4 (a) on the relevant due date.

GMRA 2000

No Formal Dispute Resolution Procedure

Paragraph 10 - “Default Market Value” - 3 Options

- (i) Buy In Proceeds / Sell Out Costs
- (ii) Offer / Bid Quotations from two or more market makers or regular dealers in the Appropriate Market in a commercially reasonable size (or determined by the non-Defaulting Party)
- (iii) Net Market Value
or (x) acting in good faith, the non-Defaulting Party has endeavoured but been unable to sell or purchase Securities....or to obtain quotations....or (y) the non-Defaulting Counterparty is determined that it would not be commercially reasonable to obtain such quotations, or that it would not be commercially reasonable to use any quotations it has obtained....

GMSLA 2009

Similar to GMRA in not having a formal Dispute Resolution Procedure

Paragraph 11.3 “Default Market Value”

- Buy In Proceeds / Sell Out Costs
- Offer / Bid Quotations
- Net Market Value

GMSLA recently updated to be more closely aligned with the Default Market Value process of the GMRA 2000.

However, GMRA 2000

Paragraph 10 - “Relevant Value”

- Offer Value / Bid Value
- Buy In Process / Sell Out Costs

Securities Borrowing & Lending Code of Guidance 2009

Paragraph 8.3

Once a decision to declare a default has been taken, it is important, in the interests of the participant, the defaulting party and the market, that the process be carried out carefully. In particular:

- the non-defaulting party should do everything within its power to ensure that the default market values used in the close-out calculations are, and can be shown to be, fair; and
- if the non-defaulting party decides to buy to sell securities consequent to the close-out, it should make every effort to do so without unnecessarily disrupting the market

OSLA (1995) and MEFISLA (1996) have similar provisions for calculating “Relevant Value -
Offer Value / Bid Value
Buy In / Sell Out

EMA (2004) Margin Maintenance Annex does not provide for specific dispute resolution

- Source of valuations when market is severely disrupted? What happens when there are no dealers making prices?
- Source of valuations where non-defaulting party has discretion to choose and has to make judgment call.
- Documentation which is not conclusive, for example,

GMRA 2000 10 (d) (i)

“Appropriate market means, in relation to Securities of any description, the market which is most appropriate market for Securities of that description, as determined by the non-Defaulting Party”.

- Use / abuse of process by potential Defaulting Party to “buy time” i.e. paragraph 4 CSA obligation “to consult with each other in an attempt to resolve the dispute”

IMPROVEMENTS / HARMONISATION



ISDA Initiative:

- 2009 ISDA Protocol for Resolution of Disputed Collateral Calls
- Purpose: Paragraph 1.2

“The purpose of this proposal is to provide a dispute resolution process for collateralized OTC derivatives that:

- (i) Achieves timely identification of the root causes of disputed collateral calls
- (ii) Ensures the prompt movement of as much collateral as the parties can mutually agree
- (iii) Provides the parties with a flexible range of methods to narrow and/or resolve their dispute to be consistent with their risk tolerance
- (iv) Creates consistent and predictable process, timing and behaviour in case of disputes across the market
- (v) Eliminates present uncertainties and delays that increase risk for the parties”

4 Steps

- Preliminary Collateralization
- Portfolio Reconciliation
- Consultation
- Dispute Resolution: Informal
 Formal

Suggestions:

- Reference / valuation sources might include prices compiled by Clearing Houses
- Upfront agreement by the Counterparty of sources to be used
- Encourage two way, firm executable prices for Dealer quotes?
- Should other Market Agreements include a pre-default formal Dispute Resolution procedure?
- Industry Expert Panel / Arbitration to resolve valuation disputes?