

IASB/FASB: Joint netting education by

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What is netting?

1. Set-off on insolvency of counterparty

- Loans vs deposits
- Trading liabilities against margin deposits

2. Close-out netting on insolvency of counterparty

- Close out of trading contracts, e.g. sale of fx, securities or commodities, or exchange of interest swap amounts
- Common process is (1) cancel contracts on default, (2) calculate losses either way, (3) set-off losses

3. Settlement netting

- Set-off of deliveries of same kind and currency falling due on the same date

Why does it matter?

- Massive reduction in insolvency exposures: risk mitigation
- Banks and customers
- Interbank deposit markets
- Securities markets
- Foreign exchange markets
- Derivatives markets, including credit default swaps
- Payment systems
- Central counterparties (see below)
- All commercial counterparty trading, including small businesses and even individuals

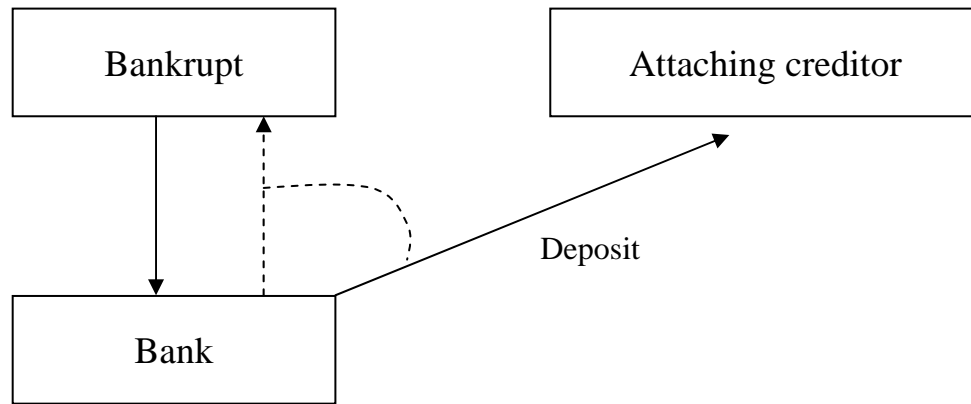
International reception of netting

- Set-off
- Contract terminations on insolvency (close-out netting)
- Financial market carve-out statutes

See attached maps

Why is everybody different?

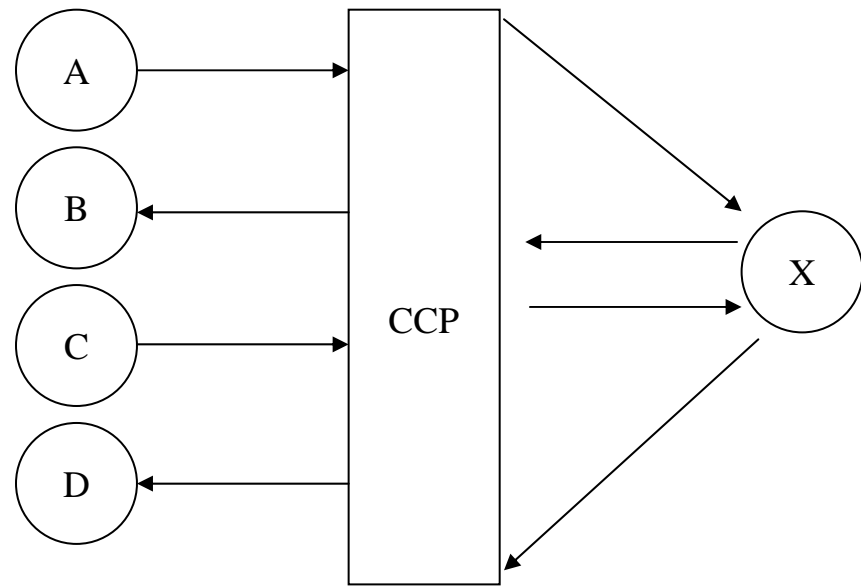
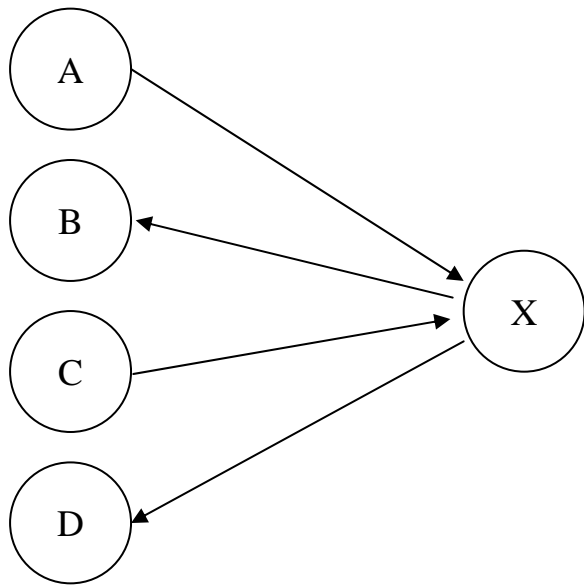
Netting must be effective against interveners



How do master agreements help netting?

- Clarity on termination rights
- Clarity on loss calculation
- Two-way payments
- Contracts to set-off often effective against intervenors
- Contracts to net necessary under some carve-out statutes
- Avoidance techniques, e.g. single agreement (unsafe in most jurisdictions if bankruptcy law prohibits netting)
- But netting possible in many jurisdictions even if no master agreement

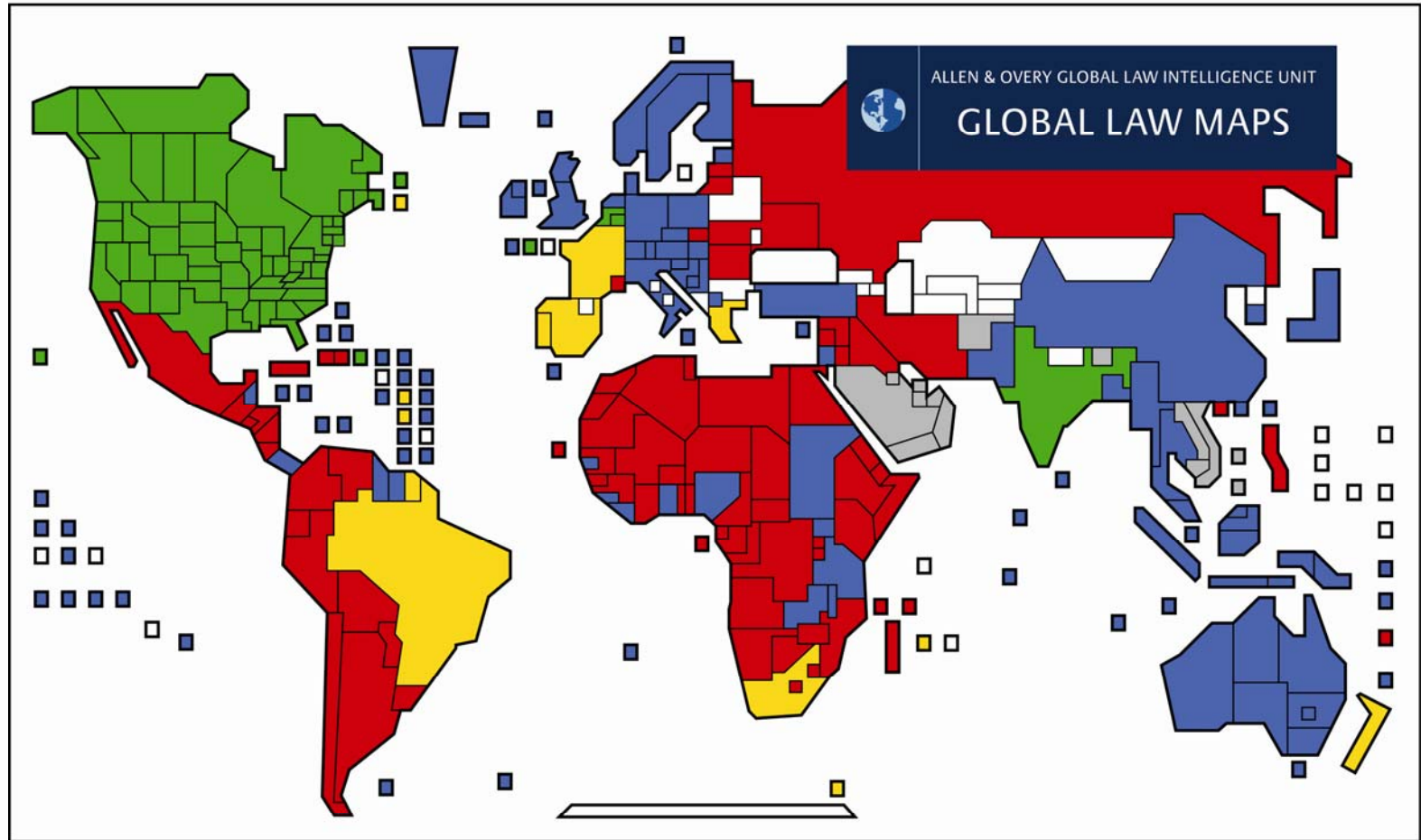
How does a central counterparty work?



Other points

- Collateral
- Conflict of laws
- Others

1. Insolvency set-off

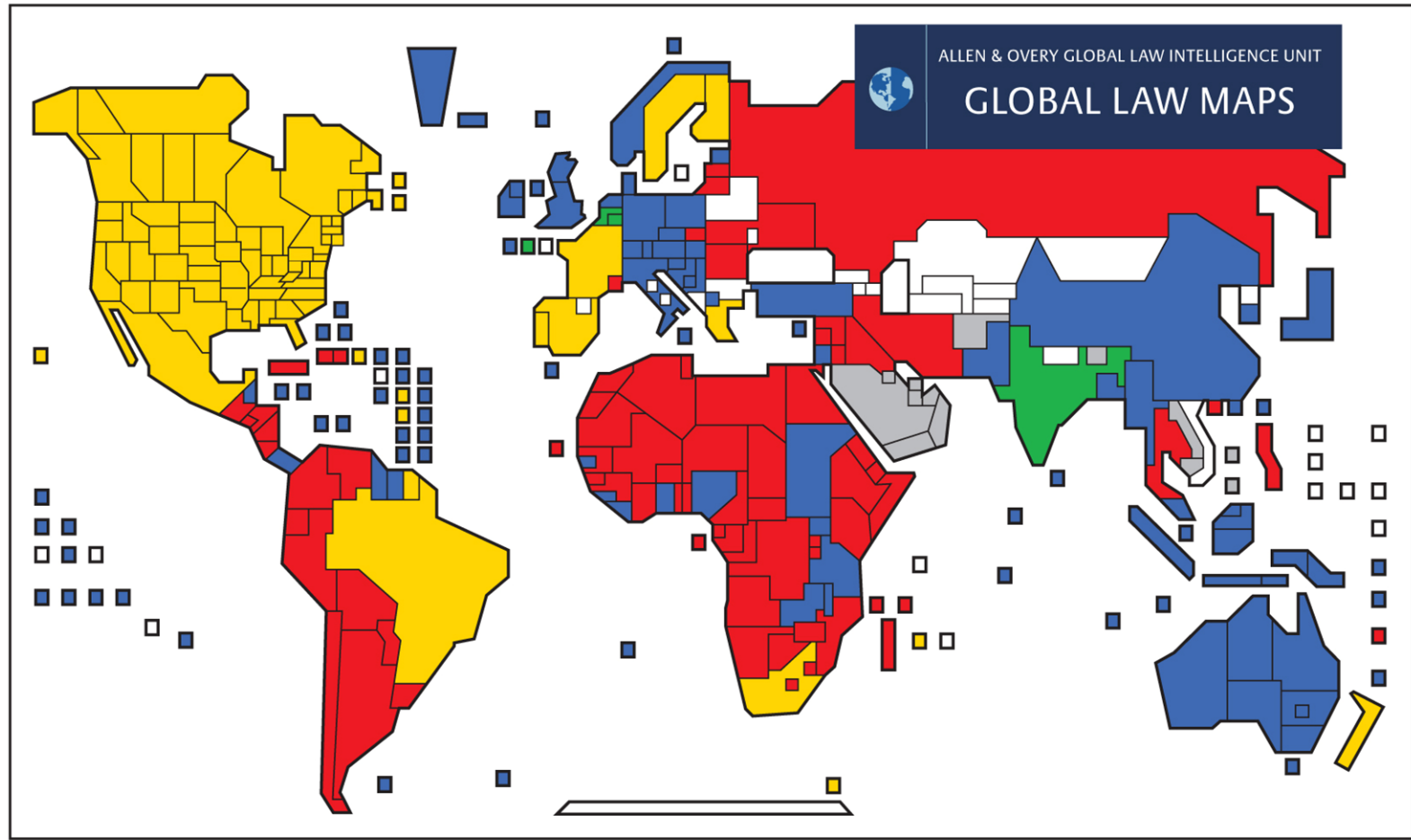


Strong set-off Weak set-off, but special statute Law uncertain
Quite strong set-off* Weak or no set-off Unallocated

* Also special statutes in US and Canada

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2. Close-out netting on insolvency



* In India, assuming abolition of "Sick Companies" legislation

3. Netting carve-out statutes

