

**DRAFT
MEMORANDUM**

TO: File
FROM: Desi Duncker
DATE: April 6, 2010
RE: Teleconference with the International Swaps and Derivatives Association, Inc. (ISDA)

This is not a transcript of the meeting and should not be quoted as such

ISDA:

Robert Pickel – Executive Vice Chairman; Karel Engelen – Director and Global Head of Technology Solutions; Nichole Framularo – Director of Trading Infrastructure; David Geen – General Counsel; Katherine Darras – General Counsel, Americas

FCIC

Tom Krebs, Landon Stroebel, and Desi Duncker

On Tuesday, April 6, 2010 Tom Krebs, Landon Stroebel, and I had a conference call with the ISDA team to discuss ISDA's role and perspective and to confirm a story we had heard about Bear Stearns. *Also, note that the following is merely a synopsis of the comments of the ISDA team and is not necessarily a statement of fact or of the opinions of the FCIC team.*

ISDA Description

Mr. Pickel noted that, before he became the Executive Vice Chairman, he had served as the General Counsel. He also noted that Ms. Framularo works on ISDA's governance and had corresponded with the New York Fed on a range of issues.

ISDA covers the derivatives markets, focusing on OTC, privately-negotiated transactions, and bilateral agreements. ISDA was formed to focus on issues in documentation, and helped to provide standard documentation. Over time, ISDA has moved to focus on regulatory interaction, risk management, and tax treatment. ISDA is a global organization, with offices in seven different locations. ISDA's members are active on various committees. ISDA is a trade organization, not a self-regulatory organization. They provide standards and definitions. They are not in the role of oversight.

Financial Crisis

ISDA provides the market tools. It's up to the parties to use and construct them. For example, AIG decided to take on subprime risk. They were looking at potential losses on trades, not on the mark-to-market exposure.

ISDA documentation provides standard structure on a bilateral basis, which was necessary given a rise in disputes due to higher volatility. The practice has been to evaluate collateral on a daily basis. The FCIC should look at the ISDA Margin Survey. The FCIC should also look at the Collateral Market Review to get a handle on the different Credit Support Annexes (CSAs).

ISDA designed best practices. In their framework they have highlighted where issues may arise. There is a range of users of derivatives, and ISDA has several committees.

Disputes

The CSAs provide for specific provisions for dispute resolution. (The ISDA team will follow-up with more details.) Parties look to resolve the full amount in a reasonable fashion, and often agree to transact a specific undisputed amount first.

As a reminder, there are many different derivatives covered, including those dealing with credit, interest rates, equities and commodities. There are two kinds of disputes. The first is the population dispute, which is less prevalent than in the past: *i.e.*, "you think we have 100 trades, and I think we have 110 trades." The second is the dispute over valuation, which reflects a difference in view.

Standard collateral documentation is structured so that either party has the ability to pledge collateral, although individual counterparties negotiate this feature. For example, AIG resisted their firm providing collateral while they were rated AAA.

Bear Stearns (BSC)

As for BSC leading up to the moments before it collapsed, the ISDA team would only say that there generally tend to be more fluctuations in value in more volatile environments.

In late March / early April 2007, Bear Stearns suggested changes to the ABS documentation. BSC provided draft wording to ISDA that there ought to be some greater flexibility to modify the terms of the underlying loans in asset-backed securities already in the market. John Paulson was concerned about the implications of this change. There was a belief that ISDA endorsed this, but

they never had a chance to rule on it, as a lower-level group of attorneys at BSC ultimately (in June 2007) pulled back on this request.

Novations

Starting in 2005, there had been a dialog between ISDA and the NY Fed. Initially this was pertaining to the backlog, and in 2007 the focus shifted to novations. A novation is an assignment of a contract. Under the Master Agreement, one needs consent to novate. For example, if hedge fund X wants Goldman Sachs to novate a trade it has with Bear Stearns, it has to get BSC's consent.

In spring 2003, ISDA highlighted the lax enforcement of the consent rule. The industry got serious, and by spring 2008, the novation process was streamlined and one could look to assign contracts to other dealer entities. Novations of contracts with Bear Stearns began to pick up a few weeks before they collapsed, and slowed down in the week before BSC went under. ISDA has no particular knowledge of GS's level of knowledge on BSC in deciding whether to novate BSC trades.

ISDA published novation definitions to make the process easier. ISDA did not issue sanctions or anything like that. ISDA published the novation protocol, and now the novation process is automated, and the written part of the consent is based on email. The process will be completely automated by the end of the year.

Financial Crisis

The crisis was caused by poor lending decisions and parties taking on significant risk through securities with subprime exposure, mortgage exposure, etc. It was not the products that caused the financial crisis—the products were just an avenue. For example, AIG used derivatives given their appetite for risk, but did not understand the risk.

Monolines

The monolines began to write the protection after AIG had stopped. They didn't have the benefit of collateral, and they were reliant on the creditworthiness of the securities rated by the rating agencies.

Follow-Up

Immediately after the call, ISDA sent the following links:

Collateral Market Review

http://www.isda.org/c_and_a/pdf/Collateral-Market-Review.pdf

Portfolio Reconciliation Best Practices

http://www.isda.org/uploadfiles/docs/Portfolio_Reconciliation_Best_Operational_Practices_2010_01_19_FINAL.doc

Portfolio Reconciliation Minimum Market Standards

http://www.isda.org/uploadfiles/docs/Minimum_Market_Standards_for_Collateralised_Portfolio_Reconciliation_Edition_1_0_Jan_20_2010.xls

Dispute Resolution Briefing

http://www.isda.org/c_and_a/pdf/ISDA-Collateral-Committee-Dispute-Resolution-Proposal-Briefing.pdf

Dispute Resolution Procedure

http://www.isda.org/c_and_a/pdf/ISDA-2009-Dispute-Resolution-Procedure.pdf

Dispute Resolution Implementation Guidelines

http://www.isda.org/c_and_a/pdf/Implementation-Guidelines-to-ISDA-2009-DR-Procedure.pdf

Independent Amount Whitepaper

http://www.isda.org/c_and_a/pdf/Independent-Amount-WhitePaper-Final.pdf

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