



Drafting Guide

# Annex I to the Master Securities Forward Transaction Agreement (the "MSFTA")

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# Annex I to the Master Securities Forward Transaction Agreement (the "MSFTA")

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This Drafting Guide discusses the elections required in Annex I: Supplemental Terms and Conditions to the 2012 Master Securities Forward Transaction Agreement (the "MSFTA") and explains the elections and some of the typical changes made by the parties. The MSFTA is a master agreement that enables the purchase and sale of forward and other delayed delivery securities by providing terms governing the relationship between the counterparties. The standard form MSFTA has 18 sections and while its terms are subject to negotiation between the parties, no modifications are made within the standard form. Elections and amendments are made in Annex I.

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<p><b>Section 1 – Other Applicable Annexes</b></p> <p>In addition to Annex I in which parties make elections and amend the standard form MSFTA, the parties can apply the other two annexes to the MSFTA.</p>	
<p><i>Annex II: Names and addresses for Communication between the Parties</i></p> <p>Parties list the names, addresses and contact information, where each party can be contacted in accordance with Section 12 of the MSFTA.</p>	<p>Some parties may want to specify different notice information for the delivery of notices of an Event of Default. This Annex does not require settlement instructions and it is market practice for each party to provide that information separately.</p>
<p><i>Annex III: Party Acting as Agent</i></p> <p>This Annex provides additional representations, obligations, and limitations on liability for a party that is acting as agent on behalf of one or more third-party principals. The Annex also clarifies the principal's liability under the MSFTA.</p>	<p>Annex III is not applicable if neither party is acting through an agent.</p> <p>Some investment managers prefer not to apply Annex III and simply provide their standard investment manager side letter.</p>
<p><b>Section 2 – Events of Default; Mini Close out</b></p> <p><b>Section 2(a) – Cure Periods</b></p> <p>The MSFTA does not include any notice requirements or cure periods before remedies can be exercised with respect to the following events of default:</p> <ul style="list-style-type: none"> <li>(i) Buyer failure to pay on Settlement Date;</li> <li>(ii) Seller failure to repay Buyer under the mini close-out provision (<i>Para 8(i)</i>), following a Seller delivery fail;</li> <li>(iii) Seller failure to deliver Securities on Settlement Date (if specified as applicable); <i>[If inapplicable, mini close-out is the exclusive remedy for such a failure.]</i></li> </ul>	<p>Section 2(a) of Annex I provides that the parties may elect to negotiate cure periods for the Events of Default (i)-(vi).</p> <p>The parties may agree that a non-performing party may not be charged with an Event of Default until the expiration of a specified cure period. The parties may specify that the cure period may begin either at the time of non-performance or at the time notice of non-performance is delivered. Cure periods are often matters of intense negotiation but, with some Dealers, it is possible to obtain a one Business Day cure (or sometimes a longer period) for all Events of Default.</p> <p>Some of the reluctance to applying a cure period for the failure to post collateral may stem from the fact that (i) under Adopted Rule 4210 Dealers who do not receive margin as required under the rule by the close of</p>

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<p>(iv) a party's failure to perform any covenant or obligation with respect to the posting and returning of collateral;</p> <p>(v) a party's failure to transfer margin under the mini close-out provision (<i>Para 8(ii)</i>), following a Seller delivery fail); and</p> <p>(vi) a party's failure to pay a termination payment under the mini close-out provision (<i>Para 8(iii)</i>), following Buyer's termination of a trade as a result of a Seller delivery fail.</p>	<p>business on the business days following the day of the call, will be required to deduct from their regulatory net capital any margin that is not collected, and/or (ii) Dealers may have offsetting trades that clear through a clearing corporation which does not permit any delays in the posting of margin..</p>
<p><b>Section 2(b) – Mini Close-out</b></p> <p>[Clause (iii) of the definition of “Event of Default” shall apply.]</p> <p>Clause (iii) states that a Seller's failure to deliver securities on the settlement date is an Event of Default.</p> <p>A special cure period for Paragraph 8(iii) is included as Section 2(a)(vii) of Annex I. Paragraph 8(iii) is the requirement to make a mini-closeout delivery. The special cure period delays the ability for buyer to invoke an Event of Default under Paragraph 8(iii) and requires the parties to hold open the failed settlement until the Section 2(a)(vii) cure period ends. The special cure period is characterized as a hold-open requirement.</p>	<p>If the parties choose to apply mini close-out, then Clause (iii) of the definition of Event of Default will be disapplied. Delivery fails are not uncommon in this market and therefore mini close-out is often applied.</p> <p>If mini close-out applies, the parties can negotiate a hold-open period in Section 2(a)(vii) of Annex I.</p> <p>It is common for influential market participants to negotiate a longer hold-open period in Section 2(a)(vii) than they do for other Events of Default. 5 business days is often seen, and occasionally even 30 business days. The rationale is that financial sellers rely on purchases from third persons, and delivery fails on those purchases are frequent and can be prolonged.</p>
<p><b>Section 2(c) – Continuing Default</b></p> <p>The words “and is continuing” should be added after the word “occurs” in the lead-in to Paragraph 7 of this Agreement.]</p>	<p>Parties can agree that the non-defaulting party may only declare an Event of Default if the default is continuing (i.e., is not cured by the defaulting party).</p> <p>This is typically acceptable. Another possibility is to add a provision that if the non-defaulting party has not declared an Event of Default within a certain period of time (e.g. 30 days), the non-defaulting party will be deemed to have waived its rights to exercise its remedies under the MSFTA with respect to that specific Event of Default.</p>
<p><b>Section 2(d) – Automatic Early Termination</b></p> <p>[In the case of an Act of Insolvency [with respect to ], the non-defaulting party's option in Paragraph 7(a) to declare an Event of Default to have occurred and cancel and otherwise liquidate and close out all (but not fewer than all) Transactions shall be deemed to have been exercised (i) immediately upon the occurrence of an Act of Insolvency specified in Paragraph 2(a)(iii) or (iv) with respect to such party, and (ii) as of the time immediately preceding the institution of the relevant proceeding or</p>	<p>It is not necessary to elect Automatic Early Termination if a party is subject to a bankruptcy or insolvency regime that has safe harbor provisions.</p>

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<p>the presentation of the relevant petition upon the occurrence of an Act of Insolvency with respect to such party specified in Paragraph 2(a)(i) or (ii).]</p> <p>A number of jurisdictions, like the United States, have bankruptcy legislation that exempt certain contracts from the automatic stay provisions, ipso facto rules, avoidance powers and the trustee or debtor-in-possession's discretion, within prescribed limits, to reject or assume the party's prepetition contracts. As a result, the non-defaulting party is entitled to close-out and net the portfolio of transactions following the bankruptcy or insolvency of its counterparty. These exemptions and protections are often referred to collectively as the "safe harbor provisions".</p> <p>If elected, Automatic Early Termination provides that the termination will have taken place immediately prior to the bankruptcy occurring.</p>	
<p><b>Section 3 – Margin Maintenance Definitions</b></p> <p><b>Section 3(a) – "Additional Margin Amount"</b></p> <p>"Additional Margin Amount", with respect to _____, USD _____; and with respect to _____, USD _____.</p> <p>Additional Margin Amount under Adopted Rule 4210 will include Maintenance Margin which is the greater of: (i) agreed amount and (ii) 2% of the net "long" or "short" position, per CUSIP.</p>	<p>Until the effectiveness of Adopted Rule 4210, the parties can negotiate whether an Additional Margin Amount (often referred to as initial margin) will apply to their relationship. Additional Margin Amount is seldom if ever applied.</p> <p>Once Adopted Rule 4210 becomes effective, Maintenance Margin will be required for all non-Exempt Accounts unless subject to the Cash Account Exemption or the Small Account Exemption. See Chart A to Exhibit A to the Master Securities Forward Transaction Agreement (the "MSFTA") Overview.</p>
<p><b>Section 3(b) – "Eligible Forward Collateral"</b></p> <p>The MSFTA, defines "<b>Eligible Forward Collateral</b>" as U.S. dollar cash, U.S. Treasury securities, such other securities as the parties may agree in the Annex, or any other securities acceptable to the party who is receiving the collateral, in its sole discretion.</p>	<p>The parties specify the class and maturities of the assets that are "Eligible Forward Collateral" to be delivered by the pledgor and in which the pledgee will obtain a security interest. The parties also agree to the valuation of the assets in determining how much collateral has been posted.</p> <p>Adopted Rule 4210 is not prescriptive as to what constitutes Eligible Collateral or the valuation percentage to be applied to such collateral. The 4210 Amendment adds a provision (Section 9) stating that if FINRA were ever to add restrictions on assets qualifying as "Eligible Forward Collateral" or margin percentages applying to such collateral, the MSFTA would be amended accordingly.</p>
<p><b>Section 3(c) – "Minimum Transfer Amount"</b></p>	<p>MTA's relieve the parties from having to make margin transfers for small amounts and incur the associated costs. The practical implications of the MTA are that the</p>

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<p>“Minimum Transfer Amount”, with respect to _____, USD____; and with respect to _____, USD____.</p> <p>The Minimum Transfer Amount “MTA” represents the level of Net Unsecured Forward Exposure that must be reached before collateral must be transferred.</p>	<p>pledgee is unsecured for any Net Unsecured Forward Exposure that is less than the MTA until the MTA is reached, at which point the whole Net Unsecured Forward Exposure must be transferred.</p> <p>Until the effective date of Adopted Rule 4210, the parties can negotiate the MTA. Upon effectiveness of Adopted Rule 4210 the MTA may not be more than \$250,000. The 4210 Amendment automatically reduces any MTA to the lesser of \$250,000 or the previously negotiated amount on that effective date.</p>
<p><b>Section 3(d) – “Threshold Amount”</b></p> <p>“Threshold Amount”, with respect to _____, USD____; and with respect to _____, USD____.</p> <p>The parties agree as to whether a Threshold Amount will be applied. The Threshold Amount is the unsecured credit granted by one party to another. The Threshold Amount, if agreed, will typically be a fixed amount.</p> <p>If a Threshold Amount is applied, the party who has the Threshold Amount will not be required to post collateral until its Net Unsecured Forward Exposure exceeds its Threshold Amount at which point it will have to post any collateral in the amount of any Net Unsecured Forward Exposure above the Threshold Amount (subject to the effect of any MTA that is negotiated by the parties).</p>	<p>Until the effective date of Adopted Rule 4210, the parties can negotiate a Threshold Amount. Adopted Rule 4210 does not allow Dealers to provide unsecured credit to their counterparties and therefore upon the effectiveness of Adopted Rule 4210, MSFTAs will have a zero Threshold Amount for counterparties. The 4210 Amendment reduces any Threshold Amount for the non-Dealer party (or both parties if agreed) to zero on the effective date of Adopted Rule 4201.</p> <p>Dealers are not prohibited from having a Threshold Amount, but as a negotiation point, Dealers are generally amenable to agreeing to a zero Threshold Amount for themselves.</p>
<p><b>Section 4 – Third Party Custody Arrangements</b></p> <p>[Notwithstanding Paragraph 4(f), any transfer of Forward Collateral provided by or on behalf of an investment company registered under the Investment Company Act of 1940 (as amended) shall be segregated with such investment company's custodian subject to a control agreement reasonably acceptable to the other party and such other party shall not be permitted to sell, transfer, assign, repledge, rehypothecate, enter into repurchase transactions or otherwise dispose of any such Collateral prior to an Event of Default by such investment company.]</p> <p>While Section 4(f) of the MSFTA allows for transfers of cash and securities, an election can be made in Annex I for the transfer of collateral by a registered investment company subject to a control agreement reasonably acceptable to the other party.</p>	<p>This provision will only be applicable to registered investment companies that are required by law to have a third-party custodian acting as a securities intermediary hold any collateral that it posts to a Dealer.</p> <p>Certain governmental agencies and trusts may also have similar legal requirements; if so, it is common to include a similar Section 4 in the MSFTA.</p>

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<p><b>Section 5 – Additional Provisions</b></p> <p>Parties may add additional provisions to the MSFTA based on their negotiations, the type of entities and their creditworthiness and their jurisdiction of incorporation. These additional provisions will typically be included in Section 5 of the Annex.</p>	<p>Additional changes that may be made in the Annex include adding events of default such as:</p> <ul style="list-style-type: none"> <li>• Credit ratings downgrade events</li> <li>• Decline in equity/net assets</li> <li>• Change in control</li> <li>• Death or resignation of key persons</li> <li>• Material adverse change</li> <li>• Cross-default provisions</li> </ul> <p>Other common additions include:</p> <ul style="list-style-type: none"> <li>• Jurisdiction and venue</li> <li>• Waiver of jury trial</li> <li>• Exclusions of non-compensatory damages and consequential damages</li> <li>• Delay of margining until effective date of revised Rule 4210</li> <li>• Agreement on pricing source in event of dispute</li> <li>• Dispute resolution provisions</li> </ul>