THE FOREIGN EXCHANGE COMMITTEE

GUIDE TO

THE 1999 COLLATERAL ANNEX TO THE

FOREIGN EXCHANGE AND OPTIONS MASTER AGREEMENT

(FEOMA),

INTERNATIONAL FOREIGN EXCHANGE MASTER AGREEMENT

(IFEMA),

OR

INTERNATIONAL CURRENCY OPTIONS MARKET MASTER AGREEMENT

(ICOM)

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DISCLAIMER

This User's Guide and related forms of documentation do not necessarily reflect the views of the Federal Reserve Bank of New York or any other component of the Federal Reserve System, or of the Foreign Exchange Committee, the Financial Markets Lawyers Group or any of their members. This Guide and such documentation do not purport to be legal advice with respect to a particular transaction or situation. If legal advice or other expert assistance is required, the services of a qualified professional should be obtained.

I. INTRODUCTION AND SCOPE

Collateralization of foreign exchange and currency option transactions has become an increasingly common market practice. Recognizing this trend, a working group of the Financial Markets Lawyers Group ("FMLG"), acting on behalf of the Foreign Exchange Committee ("FX Committee"), developed the 1999 Collateral Annex (the "Annex"). The Annex is designed to be used with the 1997 Foreign Exchange and Options Master Agreement ("FEOMA"), the 1997 International Foreign Exchange Master Agreement ("IFEMA"), or the 1997 International Currency Options Market Master Agreement ("ICOM") published by the Foreign Exchange Committee, in association with the British Bankers' Association, the Canadian Foreign Exchange Committee, and the Tokyo Foreign Exchange Market Practices Committee (together, the "Master Agreements"). The Annex also may be adapted to support prior versions of these Master Agreements.

The Annex has been developed to provide market participants documentation they can use for collateral arrangements supporting obligations arising from a Master Agreement, with the intent of reflecting and encouraging sound market practice. While the Annex contains certain standard terms, its provisions are flexible and can be conformed to the individual needs of the user. The Annex is a one-way agreement, for arrangements in which one Party (the "Pledgor") pledges Collateral to secure its obligations arising from FX Transactions and/or Options (the "Transactions") entered with the other Party (the "Secured Party") under a Master Agreement. The Annex is designed to cover Transactions between the Parties to a Master Agreement and, accordingly, does not cover Transactions with affiliates of the Parties (see Part II below). The FMLG decided to publish an Annex that would accommodate one-way pledges common to the foreign exchange markets and to further assess the need to publish documentation supporting the Master Agreements for more complex bilateral collateralization arrangements.

Because U.S. Dollars and Treasury Securities are the prevalent types of collateral in the foreign exchange markets, the Annex is drafted to specifically accommodate pledges of these types of Eligible Collateral under New York and other applicable law. Should the Parties wish to permit use of other types of Eligible Collateral, such as non-U.S. Dollar Currencies, U.S. agency securities or other securities, it may be necessary to adapt certain provisions of the Annex to them (see Part III.C.2 below). The Annex specifies procedures by which the Parties should deliver Eligible Collateral, and return and maintain Collateral, to ensure that the Total Exposure as defined under the Annex continues to be secured on at least a daily mark-to-market basis.

The nature of foreign exchange markets and FX Transactions presents specialized issues that differ from issues associated with products covered by other industry standard collateral, margin, and credit support annexes. For example, a substantial percentage of FX Transactions are spot transactions that settle within two business days of the day on which they are executed. The mark-to-market value of a portfolio of FX Transactions can change dramatically each day, as Parties settle existing spot FX Transactions and enter into new FX Transactions. As a result, the drafters of the Annex considered it important to provide for a short time-frame for delivery and return of collateral. This helps to ensure that the calculations of net mark-to-market exposure that result in collateral adjustments do not take into account FX Transactions that already have settled and should no longer be relevant. In this regard, users of the Annex should pay close attention to the provisions relating to delivery and return of collateral and resolution of disputes regarding valuation and delivery and return of collateral. Users of the Annex also should note that these provisions were designed for use when only one Party is obligated to provide collateral, and issues relating to dispute resolution may differ when both Parties are required to provide collateral.

In addition, some Parties may find it operationally difficult to measure the value of all FX Transactions due to their volume and daily changes as to which FX Transactions remain unsettled. Because of such operational concerns and the quickly changing nature of the valuation of FX Transactions, some Parties may decide to exclude certain types of FX Transactions entirely from the Annex. The Annex presumes that the Parties intend to collateralize the Net Exposure (as defined under the Annex) arising from all Transactions that the relevant Master Agreement governs, including foreign exchange spot, forward, and/or currency option transactions (and related premiums). However, the Annex can be adapted to arrangements under which exposures for certain classes of Transactions are not to be collateralized under the Annex (see Part III.A.14 below).

The FMLG, on behalf of its members and members of the FX Committee, obtained a legal opinion on the enforceability of the provisions of the Annex under New York and other applicable law. The Secured Party should consider whether it needs to obtain legal opinions regarding the enforceability of the provisions of the Annex under New York law, and under the laws of any other jurisdictions, as may be relevant for the forms of Collateral pledged under the Annex.

Part II of this Guide explains the provisions of the Heading Sheet. Part III discusses the terms of the Annex and raises questions and issues for practitioners' consideration. Part IV provides revisions that may be made to the Annex to adapt it to the 1992 ICOM and 1993 IFEMA. Capitalized terms used in this Guide have the meanings ascribed to them in the Annex or the relevant Master Agreement, unless this Guide otherwise specifies. This Guide in no way constitutes part of, or should be interpreted as modifying, any provisions of the Agreement, including the Annex.

II. HEADING SHEET

On the Heading Sheet of the Annex, the Parties document the date on which they execute the Annex, designate the Pledgor and the Secured Party, and specify the Master Agreement (FEOMA, IFEMA or ICOM) in effect between the Parties which the Annex supports. The Annex, together with its Schedule, becomes part of the Agreement between the Parties (see Section 2.2 of the FEOMA, IFEMA, or ICOM).

The Secured Party and the Pledgor under the Annex must be the only Parties to the Master Agreement. The Annex is designed to secure only the obligations of the Pledgor to the Secured Party under the relevant Master Agreement. The Annex does not cover more than one entity of either the Secured Party or Pledgor or obligations of, or collateral provided on behalf of, affiliates of the Parties. Accordingly, the Annex would not cover foreign currency options if the institution books such transactions in an affiliate. Accommodating this practice would require a separate cross-collateralization agreement with specialized terms, although provisions of the Annex could be useful to developing such an agreement.

In addition, if an institution has separately executed an ICOM and an IFEMA with the same counterparty, the institution may execute one Annex for each Master Agreement. In this case, the net exposures arising from currency options covered by the ICOM and foreign exchange transactions covered by the IFEMA would be separately calculated and collateralized in accordance with the terms of the Annex. In order to achieve collateralization on a fully netted basis, the institution would need to enter into a separate cross-collateralization agreement or a collateralized master-master netting agreement with the counterparty.

III. ANNEX TERMS

A. Section 1.1. Definitions

1. Business Day

For purposes of the transfer of Collateral, Section 1.1(a)(i) provides that a Business Day is a day, in the places where relevant accounts are located, on which commercial banks are not authorized or required by law to close (and which is not a Saturday or a Sunday). For purposes of receiving notice, Section 1.1(a)(ii) provides that a Business Day is a day, in the place where the collateral management office of the receiving Party is located, on which commercial banks are not authorized or required by law to close (and which is not a Saturday or a Sunday).

The locations of the collateral management offices of both Parties should be specified in Part XII of the Schedule. Specifying these locations is important because the collateral management office of a Party may differ from the Party's Designated Office in the Master Agreement, which must be open for there to be a Business Day for certain purposes under the Master Agreement (see the definition of "Business Day" under the FEOMA, IFEMA, or ICOM and Part II of the Schedule thereto). In contrast, the definition of Business Day for purposes of receiving notices under the Annex is based on the location of the collateral management office, which is where the Annex provides such notices must be sent.

The effect of the definition of "Business Day" in Section 1.1(a)(i)-(ii) of the Annex is that deliveries of additional Eligible Collateral (or returns of excess Collateral) are not required until the collateral management offices and relevant custodians of both Parties are open for business. Each plays an essential role in the collateral transfer process. Part III.D.4 below discusses how the Business Day requirement impacts the timing of collateral transfers and potential risk issues. Parties should carefully consider the implications of the definition of "Business Day" and determine whether the definition in the Annex is appropriate for their relationship or whether they need to define this term differently in the Schedule.

For all other purposes, Section 1.1(a)(iii) provides that a Business Day is a day in the location of the relevant office of the relevant party on which commercial banks are not authorized or required by law to close (and which is not a Saturday or a Sunday). For instance, the office of the Secured Party must be open in order for the Secured Party to have an obligation to revalue the Collateral and exposure to the Pledgor (see Section 3.1 of the Annex).

2. Close-Out Netting Provision

The Close-Out Netting Provision is defined to cross-reference provisions of the Master Agreement that govern close-out and liquidation of Currency Obligations and/or Options governed by the Master Agreement. Provisions of the Schedule to the FEOMA or IFEMA governing close-out netting of cash-settled foreign exchange transactions are included in this definition if they have been elected as applicable in such Schedule. The Annex uses the Close-Out Netting Provision definition to provide a mechanism for determining the Net Exposure arising from the Master Agreement at any point in time (see Part III.A.14 below).

3. Collateral

Collateral includes Eligible Collateral and other property that has been transferred to the Secured Party pursuant to the Annex, together with all payments, distributions, and proceeds received or to be received and products thereof (including income, interest, principal, cash, dividends, instruments and discounts). The term Eligible Collateral refers to the types of currencies, securities or instruments that the Parties have agreed are eligible to be pledged, but that have not yet been pledged, under the Annex (see Part III.A.9 below).

4. Collateral Annex Event of Default

An Event of Default as defined in the Master Agreement entitles the Non-Defaulting Party to close out and liquidate all outstanding Currency Obligations and Options. The Annex allows the Parties to identify, in Part VI of the Schedule, additional Collateral Annex Event(s) of Default. Under the Annex, occurrence of an Event of Default or a Collateral Annex Event of Default with respect to the Pledgor will trigger certain rights and remedies for the Secured Party. These relate to the Secured Party's right to withhold excess Collateral (see Sections 3.3, 5.4, and 5.5 of the Annex) and to liquidate Collateral and apply the proceeds against the Pledgor's obligations under the Agreement (see Section 7.1 of the Annex).

The Annex permits specification of Collateral Annex Event(s) of Default in recognition that Events of Default as defined in the Master Agreement may not be tailored or sensitive to concerns raised by particular collateralized counterparties. For example, a shorter grace period may be specified for failure to pay or to perform under the Agreement than the grace period provided for in the Master Agreement. In addition, different types of events, other than those that constitute Events of Default under the Master Agreement, may be appropriate under the circumstances. If the Secured Party desires grace periods or protection for events other than those defined in the Master Agreement as Events of Default, it must specifically negotiate these events with the Pledgor as Collateral Annex Events of Default. Occurrence of a Collateral Annex Event of Default also would constitute an Event of Default under the terms of the Master Agreement and, if it is continuing, would trigger close-out netting rights under the Master Agreement as well as rights under the Annex. See Part III.H.1 below for further discussion.

5. Collateral Percentage

A Collateral Percentage must be specified as the applicable haircut for each type of Eligible Collateral included in Part I of the Schedule. Section 1.1(f) of the Annex presumes that, unless otherwise specified in Part I, there is no haircut on U.S. Dollar Collateral (i.e., the Collateral Percentage is 100 percent). There is no presumption in the Annex with respect to other types of Eligible Collateral listed in Part I. Accordingly, the

Parties should ensure that a Collateral Percentage of 100 percent is specified if they do not intend to apply a haircut to a particular type of Eligible Collateral listed in Part I.

There may be circumstances in which the Secured Party accepts as Eligible Collateral a type that is not specified in Part I. The Parties may agree to a haircut for such type of Eligible Collateral, which also will be given effect as a Collateral Percentage for purposes of the Annex.

6. Collateral Value

Collateral Value is measured as the aggregate fair market value of all Collateral that is Eligible Collateral, as determined by the Secured Party at any time in good faith and in a commercially reasonable manner, after each type of Eligible Collateral is multiplied by the applicable Collateral Percentage (i.e., haircut). No value is given to any Collateral that does not constitute Eligible Collateral.

The Annex does not attempt to specify how the Parties should value Eligible Collateral in recognition that different valuation methods can be commercially reasonable depending on prevailing circumstances. If the Parties use the Annex to take forms of Eligible Collateral other than U.S. Dollars or U.S. Treasury Securities, it would be advisable to agree up front on how to value such forms of Eligible Collateral in order to avoid disputes.

7. Credit Support Priority Provision

The Credit Support Priority Provision is defined to cross-reference provisions of the Master Agreement that determine the priority of a Credit Support Document, such as the Annex, in the event of inconsistency with other provisions of the Agreement. See Section 1.2 of the Annex, discussed in Part III.B below.

8. Cut-Off Time

The Cut-Off Time, which is the time specified in Part VII of the Schedule, is a deadline for receipt of notice by the relevant Party for purposes of demanding delivery of Eligible Collateral or return of Collateral. Whether notice is received on or before the Cut-Off Time determines when Eligible Collateral must be delivered, or when Collateral must be returned, by the Party receiving notice. See Section 3.4 of the Annex, discussed in Part III.D.4 below.

9. Eligible Collateral

Eligible Collateral consists of the Currencies, securities or other instruments that are permitted in Part I of the Schedule, or that at any time the Secured Party accepts as Eligible Collateral. In Part I of the Schedule, types of Eligible Collateral and applicable Collateral Percentages are specified. Part I may be amended by mutual agreement of the Parties or at the Secured Party's sole discretion upon notice to the Pledgor. See Section 8.4 of the Annex, discussed in Part III.I.4 below.

As noted above, the Annex presumptively covers U.S. Dollars and U.S. Treasury Securities as Eligible Collateral, which are the most common collateral in the foreign exchange markets. Part I of the Schedule, however, facilitates the use of other types of Eligible Collateral under the Annex, such as non-U.S. Dollar currencies, U.S. government agency securities and other types of securities. In addition, the Secured Party has discretion to accept any Currencies, securities, or instruments as Eligible Collateral under the Annex even if they are not included in Part I. This provides the Parties the flexibility to make arrangements on short notice for collateralization with types of Eligible Collateral not contemplated in the normal course. For example, if the Pledgor does not have available securities that the Secured Party has demanded in a collateral call, the Secured Party instead may accept cash as Eligible Collateral.

The Annex may not specify how Eligible Collateral other than U.S. Dollars and Treasury Securities should be transferred or pledged. If the Parties wish to make use of other types of Eligible Collateral, their legal counsel should be consulted to determine whether the Annex provides mechanisms for transfer or payment of these types of Eligible Collateral or, alternatively, whether mechanisms should be specified in the Schedule to the Annex. See Part III.C.2 below for further discussion.

10. Force Majeure, Act of State, Illegality, and Impossibility Provision

The Force Majeure, Act of State, Illegality, and Impossibility Provision is defined to cross-reference the provisions of the Master Agreement that are triggered when certain events affect the ability of a party to perform under the Master Agreement. The FX Committee published in December, 1999 a revised version of the Force Majeure, Act of State, Illegality, and Impossibility Provision of the 1997 FEOMA, IFEMA, and ICOM. The Annex captures the revised version if it has been adopted by the Parties. If the Parties have not adopted the revised version, the version that appears in the 1997 Master Agreement applies for purposes of the Annex. For purposes of the Annex, if such Provision is triggered, the Secured Party may not be obligated to return excess Collateral to the Pledgor. See Sections 3.3, 5.4, and 5.5 of the Annex, discussed in Part III.D.3 below.

11. Independent Amount

The Independent Amount defined by the Parties in Part IV of the Schedule as a fixed amount or as a formula, provides a means of requiring collateralization of an amount of exposure over and above the Net Exposure. The Independent Amount may be used to require initial margin, so that the Secured Party receives additional protection against potential volatility in Collateral Value (and Net Exposure) pending receipt of additional Eligible Collateral. Because institutions have different approaches toward determining the Independent Amount, and there is no single industry standard, the Annex permits the Parties to specify in Part IV of the Schedule the method that would apply in their situation. Different methods in use in the industry include a percentage of notional value, Value-at-Risk (VAR) modeled overnight exposure, net open position, or a fixed amount. If not otherwise specified, the Independent Amount is zero.

12. Master Agreement

The Master Agreement is documented on the Heading Sheet as the Master Agreement that the Annex supports. The Annex is designed to support the 1997

FEOMA, the 1997 IFEMA or the 1997 ICOM. However, it can be adapted to support prior versions of these Master Agreements (see Part IV below).

13. Minimum Delivery Amount and Minimum Return Amount

The Minimum Delivery Amount, specified in Part VIII of the Schedule, is a threshold amount of Eligible Collateral below which delivery thereof to the Secured Party will not be required. The Minimum Return Amount, specified in Part VIII of the Schedule, is a threshold amount of Collateral below which return thereof to the Pledgor will not be required. See Section 3.4 of the Annex, discussed in Part III.D.5 below.

14. Net Exposure

Net Exposure is the amount that the Secured Party calculates from time to time as payable by the Pledgor to the Secured Party under the Close-Out Netting Provision of the Master Agreement. For purposes of this calculation, the Secured Party is assumed to be the Non-Defaulting Party, even when no Event of Default has occurred. As determined under the Close-Out Netting Provision, the Net Exposure would be the net mark-to market value (replacement cost) of all Transactions outstanding under the Master Agreement at the time that the Secured Party performs the valuation. The Secured Party measures the Net Exposure at a minimum on each Business Day, adding it to the Independent Amount to determine Total Exposure and, in turn, the Required Collateral Amount. See Part III.D.1-3 below for further discussion.

Accordingly, net mark-to-market value (replacement cost) is the presumed base measure of exposure to be collateralized under the Annex. The Annex presumes that the Secured Party includes in its Net Exposure calculation all outstanding FX Transactions, Options, and Premiums receivable and payable. In recognition that the Parties may decide not to follow these presumptions, the Parties can exclude any class(es) of FX Transaction, Option or Premium from coverage under the Annex in Part XIII of the Schedule. The Secured Party would have to enter into a separate arrangement with the Pledgor if it wants to collateralize exposure arising from Transactions excluded from the Annex, or may adapt the Annex to collateralize such exposure through appropriate revisions to the definition of the Total Exposure (see Part III.A.22).

A large percentage of FX Transactions are spot transactions that settle within two business days (or even shorter-dated FX Transactions that settle on the next day or the same day). Because the settlement of spot FX Transactions can cause the mark-to-market valuation of a portfolio to change substantially from day to day, making it difficult to monitor Net Exposure and to accomplish transfers of collateral back and forth, some Parties may choose to exclude such Transactions under Part XIII of the Schedule. Another method used to minimize the frequency of collateral transfers is to elect to use a sufficient Threshold Amount (as discussed in Part III.A.21 below), assuming that the credit risk arising from the use of such Threshold Amount is acceptable to the Secured Party.

The Annex does not address settlement risk arising from deliverable FX Transactions. Consistent with market practice, the Net Exposure covers only mark-to-market value prior to settlement date. In contrast, foreign exchange settlement risk to the Secured Party arises only if and when the Secured Party pays the currency it sold without receiving the currency it bought under a foreign exchange transaction. The Secured Party would need to consider mechanisms outside of the Annex to limit settlement risk.

15. Pledgor

The Pledgor is the Party designated as such on the Heading Sheet. The Annex covers only obligations under the Master Agreement of a single Pledgor and not of any of its affiliates (see Part II above).

16. Required Collateral Amount

The Required Collateral Amount is the amount by which the Total Exposure exceeds the unsecured Threshold Amount. If Total Exposure exceeds the Threshold Amount, the Required Collateral Amount must be delivered to the Secured Party upon appropriate request. If the Collateral Value exceeds the Required Collateral Amount, the Secured Party must return the amount of such excess to the Pledgor upon appropriate request (and subject to certain conditions, discussed in Part III.D.3 below).

17. Secured Party

The Secured Party is the Party designated as such on the Heading Sheet. The Annex covers only Transactions under the Master Agreement with a single Secured Party and not with any of its affiliates (see Part II above).

18. Set-Off Provision

The Set-Off Provision is defined to cross-reference provisions of the Master Agreement that allow the Non-Defaulting Party, in the event of termination and close-out under the Agreement, to set-off the amount owed to it pursuant to the Close-Out Netting Provision against the value of Collateral then held by such Party under a Credit Support Document. The Set-Off Provision is referred to in Section 7.2 of the Annex in order to make clear that the Secured Party has set-off rights against Collateral upon occurrence and continuation of an Event of Default (or Collateral Annex Event of Default). Under the Set-Off Provision, non-U.S. Dollar denominated Collateral would be converted into the Secured Party's Base Currency in accordance with the terms of the Master Agreement, and the liquidated value of non-cash Collateral would be used.

19. Suspension of Obligations Provision

The Suspension of Obligations Provision is defined to cross-reference and incorporate provisions of the Master Agreement that allow the Non-Defaulting Party, under certain circumstances, to suspend its obligations to perform under the Agreement. Under such provisions, this generally can occur when a Party is in default in payment or performance to the other Party under the Master Agreement, and the Non-Defaulting Party has not yet exercised its rights to close-out and liquidate. This also can occur if "Adequate Assurances" has been elected in the Agreement, and a reasonable request for Adequate Assurances has been made, but the Defaulting Party has not yet responded.

The Suspension of Obligations Provision applies to the Secured Party's and the Pledgor's obligations to perform under the Annex, which is part of the Agreement. In addition, the Annex explicitly references the Suspension of Obligations Provision to make clear that such Provision applies to the obligation of the Secured Party to return excess Collateral to the Pledgor (see Section 3.3(b) of the Annex), including excess Collateral that constitutes interest and dividends (see Section 5.4 of the Annex) and earnings on U.S. Dollar Collateral (see Section 5.5 of the Annex).

20. Termination Provision

The Termination Provision is defined to cross-reference and incorporate the provisions of the Master Agreement that allow either Party to terminate the Agreement at any time upon seven (7) days' written notice. The Termination Provision is referred to in Section 8.6 of the Annex, which governs termination of the Annex (see Part III.I.6 below).

21. Threshold Amount

The Threshold Amount, and the formula by which to calculate it, should be specified in Part V of the Schedule. The purpose of designating a Threshold Amount is to permit a level of uncollateralized exposure under the Annex, based on factors such as the Pledgor's creditworthiness and volume of business. In recognition that institutions use different methods to determine permitted unsecured exposures for particular counterparties, the Annex gives flexibility to specify such methods. For example, the Threshold Amount can be defined in Part V as fixed amounts that vary depending on the credit rating of the Pledgor's publicly issued debt. The Threshold Amount is subtracted from the Total Exposure in order to calculate the Required Collateral Amount for purposes of delivering Eligible Collateral and returning Collateral (see Section 3.2 of the Annex).

If an Event of Default or a Collateral Annex Event of Default has occurred and is continuing with respect to the Pledgor, then the Threshold Amount becomes zero. Accordingly, the Secured Party would have the right to demand additional Eligible Collateral from the Pledgor to cover the entire Total Exposure (without deduction of any specified Threshold Amount). Legal counsel should be consulted to determine whether the Secured Party is able to legally enforce such right against a Pledgor in the event of its bankruptcy or insolvency.

22. Total Exposure

Total Exposure is calculated by adding the Independent Amount to the Net Exposure. Total Exposure represents the total amount of exposure of the Secured Party to the Pledgor that must be continuously collateralized under the Annex. If the Total Exposure is negative, the Pledgor is entitled to require return of excess Collateral as provided in Section 3.3 of the Annex.

23. TRADES Regulations

The TRADES Regulations govern the use and operation of the Treasury/Reserve Automated Debt Entry System (TRADES). Its provisions address, among other things, creation and perfection of Security Entitlements to Treasury Securities by credit to Securities Accounts held at a Federal Reserve Bank. The TRADES Regulations are referred to in Section 2.2(b) of the Annex, which specifies how an effective pledge of U.S. Treasury Securities is made under the Annex.

B. Section 1.2. Inconsistencies

Section 1.2(a) provides that the terms of the Annex prevail with respect to its subject matter in the event of inconsistency with any other provision of the Agreement. This rule of priority explicitly reverses the presumption in the Credit Support Priority Provision of the Master Agreement that other provisions of the Agreement generally take priority over provisions of any Credit Support Document. It was deemed appropriate to reverse such presumption because the provisions of the Annex are more likely to reflect the intent of the Parties with respect to terms of their collateral arrangement.

Section 1.2(b) provides that, in the event of inconsistency, the provisions of the Schedule to the Annex take priority over other provisions of the Annex. If the Parties use a Confirmation to specify terms that otherwise would be specified in the Schedule, this rule of priority adheres for such terms as if they were included in the Schedule. See Section 8.1 of the Annex, discussed in Part III.I.1 below.

C. Section 2. Security Interest and Delivery

1. **SECTION 2.1.** Security Interest

Under Section 2.1, the Pledgor grants to the Secured Party a first priority continuing security interest, lien on, and right of set-off against, all Collateral transferred to (or otherwise received by) the Secured Party pursuant to the Annex. Such security interest, lien, and right of set-off continue until the Secured Party returns the Collateral by transfer to the Pledgor pursuant to Section 2.2 of the Annex.

2. **SECTION 2.2.** Transfer/**SECTION 2.3.** Other Action

Transfers of Eligible Collateral to the Secured Party and of Collateral to the Pledgor will be effective only when the steps specified in Section 2.2 with respect to the relevant form of Collateral have been completed. The Pledgor and Secured Party have not fulfilled their obligations to deliver Eligible Collateral or to return Collateral until the steps specified in Section 2.2 have been taken. Accordingly, the risk of custodial failure is on the Pledgor for delivery of Eligible Collateral and on the Secured Party for return of Collateral.

With regard to U.S. Dollars, Section 2.2(a) permits the Parties (or their agents) to designate an account to receive transfer of funds. Section 2.2(a) does not contemplate pledges of non-consumer deposit accounts under applicable law (such as the revised version of Article 9 of the Uniform Commercial Code ("U.C.C."), which becomes effective July 2001). Parties should consult with their legal counsel if there is an intention to pledge non-consumer deposit accounts under the Annex. If necessary, the steps to be taken to transfer control over demand deposit accounts to the Secured Party may be specified in Part II of the Schedule.

With regard to Treasury Securities, Section 2.2(b) contemplates two situations, one in which the receiving Party itself has an account at a Federal Reserve Bank and the other in which the receiving Party's custodian (or subcustodian) has an account at a Federal Reserve Bank. In the latter case, either the custodian (or subcustodian) must be specified as the receiving Party's Securities Intermediary in Part II of the Schedule, or the Securities Intermediary must be "otherwise designated" by the receiving Party or its agent. The "otherwise designated" language permits a receiving Party's custodian to act through one or more subcustodians that are Securities Intermediaries with accounts at a Federal Reserve Bank (without specifying them in Part II of the Schedule). The receiving Party would want to ensure that appropriate arrangements are in place between itself and its Securities Intermediary, or its custodian and relevant subcustodians, to ensure transfers of Treasury Securities are effective under this provision.

Section 2.2(c) gives the Parties the option of using other forms of Collateral, such as non-U.S. Dollar Currencies, U.S. government agency securities and other types of securities. As discussed in Part III.A.9 above, the Annex may not specify how Eligible Collateral other than U.S. Dollars and U.S. Treasury Securities should be transferred or pledged. Under Section 2.3 of the Annex, the Pledgor agrees to take any other action that the Secured Party may reasonably require in order to perfect the Secured Party's first priority continuing security interest in, lien on, and right of set-off against any Collateral. Legal counsel should be consulted to determine whether Section 2.3 provides a sufficient basis for pledging forms of Collateral other than U.S. Dollars and Treasury Securities.

When Parties anticipate using other forms of Eligible Collateral in the normal course, it would be prudent to specify in Part II of the Schedule the steps required for the transfer or payment of such Eligible Collateral. Such steps should be described in a manner that would transfer control of such Eligible Collateral to the Secured Party, in order to ensure that the Secured Party would obtain a continuing first priority, perfected security interest in such Eligible Collateral as provided in Section 2.1 of the Annex. Likewise, such steps must be completed for the Secured Party to satisfy its duty to return the relevant type of Collateral back to the Pledgor. Transfer mechanisms also may be included in a related Confirmation. See Section 8.1 of the Annex, discussed in Part III.I.1 below. Parties that desire to use other types of Eligible Collateral also should consider whether the Annex's collateral transfer cycle would be feasible, given the amount of time necessary to notify relevant custodians and effect a transfer of such Eligible Collateral. See Part III.D.4 below for further discussion.

To provide mechanisms for payment of non-U.S. Dollar Currencies, legal counsel may wish to consider using or adapting the language of Section 2.2(a) of the Annex in Part II of the Schedule to the particular collateral arrangement. The locations of relevant accounts to which funds must be credited may be specified. To provide mechanisms for transfer of U.S. government agency securities and U.S. equity or debt securities in Part II of the Schedule, legal counsel may wish to consider using or adapting the following provisions to the particular collateral arrangement.

With respect to Eligible Collateral that is a U.S. government agency security (other than a Treasury Security):

(a) (i) a Federal Reserve Bank indicates by book-entry that such Security has been credited to a Participant's Securities Account, which Participant is the receiving Party; or (ii) a Federal Reserve Bank indicates by book-entry that such Security has been credited to a Participant's Securities Account, which Participant is a Securities Intermediary specified in Part III of the Schedule hereto or otherwise designated by the receiving Party or its agent, and such Securities Intermediary indicates by book entry that a Security Entitlement to such Security has been credited to the securities account (as defined under the law of such Securities Intermediary's jurisdiction) of the receiving Party, its agent, or a nominee of either.

(b) For purposes of the above subsection (a), capitalized terms not defined in the Annex have the meanings specified in the book-entry regulations of a U.S. government agency that govern the particular type of Eligible Collateral.

Note that the above provisions for U.S. government agency securities track Section 2.2 of the Annex for transfers of Treasury Securities. Several U.S. government agencies adopted book-entry regulations that are substantially identical to TRADES. However, the legal practitioner should ensure that this language is consistent with the book-entry regulations applicable to the particular type of U.S. government agency security.

With respect to Eligible Collateral that is a security to which the 1994 revised versions of Articles 8 and 9 of the U.C.C. apply:

(a) For purposes of the following subsections (b), (c) and (d), the terms "certificated security," "clearing corporation," "securities account," "security," "security entitlement," "securities intermediary," and "uncertificated security" have the meanings specified in the Uniform Commercial Code as in effect and interpreted by the courts in the State(s) of **_______________**.[1]

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[1] The legal practitioner should ensure that the 1994 revised versions Articles 8 and 9 of the U.C.C. are in effect in the State(s) whose laws apply to determine the receiving Party's (both the Secured Party's and the Pledgor's) interest in the securities. If any other State or foreign laws apply under relevant choice of law rules, this language may not be adequate because there may be different or additional requirements that must be met to transfer control of Eligible Collateral to the receiving Party.

(b) In the case of an uncertificated security (not credited by book-entry to a securities account), the issuer (i) registers as the registered owner the receiving Party or its agent[2] for the benefit of the receiving Party, or (ii) has agreed that it will comply with instructions originated by the receiving Party without further consent of the registered owner.

(c) In the case of a certificated security (not credited by book-entry to a securities account): (i) if such security is in bearer form, the certificate is delivered in appropriate physical form to the receiving Party or its account; or (ii) if such security is in registered form, the certificate is (1) delivered in appropriate physical form to the receiving Party (or its agent) and indorsed in blank or specially indorsed to the receiving Party (or to its agent for the benefit of the receiving Party[3]), or (2) delivered in appropriate physical form to the receiving Party (or its agent) and registered in the name of the receiving Party (or its agent for the benefit of the receiving Party), and the certificate is accompanied by any transfer tax stamps and other documents as the receiving Party (or its agent) may reasonably request as necessary to constitute a legally valid transfer.

(d) In the case of a security entitlement (other than to a Treasury Security or a U.S. government agency security), a clearing corporation specified by the receiving Party indicates by book-entry that a security has been credited to the securities account of (i) the receiving Party, or (ii) a securities intermediary specified by the receiving Party or its agent, and such securities intermediary indicates by book-entry that its security entitlement to such security has been credited to the securities account of the receiving Party or its agent.

D. Section 3. Valuations and Collateral Maintenance

1. **SECTION 3.1.** Valuations

Section 3.1 requires the Secured Party to calculate the Total Exposure and mark-to-market the Collateral at least once each Business Day, in accordance with sound market practice. In the foreign exchange markets, frequent collateral and exposure valuations are the norm. Given the volatile nature of many of these markets, requiring at least daily valuations helps protect the Secured Party against fluctuations in Net Exposure. It is contemplated that the Secured Party will provide the Pledgor with

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2 Under Section 8-301(b)(2) of the New York U.C.C., the agent in this context may not be a securities intermediary.

3 Under Section 8-301(a) of the New York U.C.C., if the receiving Party's agent is a securities intermediary, the certificate must be specially indorsed to the receiving Party.

information on valuations in the normal course of business outside of the framework set up by the Annex.

In recognition that institutions have different collateral management practices, the Annex permits the Secured Party to determine the frequency with which it will perform valuations. The Secured Party must calculate Total Exposure and Collateral Value at least once each Business Day, but it has discretion to perform valuations more than once each Business Day, or on a real-time basis. The Net Exposure arising from a portfolio of FX Transactions substantially changes during the day as a result of settlement of spot FX Transactions, which customarily comprise a large percentage of such portfolios. The Secured Party should consider how the time cycle for collateral delivery and return works under the Annex if it decides to perform more frequent than daily valuations, which may result in the need to adjust collateral levels. For example, on Day One, the Secured Party calculates Net Exposure and provides the Pledgor information on its calculation. The Pledgor provides the Secured Party notice for return of $10 excess Collateral after the Cut-Off Time on Day One. The Secured Party is required to return the Collateral to the Pledgor by close of business on Day Two. On Day Two, the Secured Party calculates Net Exposure and provides notice to the Pledgor for delivery of $5 additional Eligible Collateral before the Cut-Off Time. As a result, the Secured Party has an obligation to return $10 of Collateral by close of business on Day Two, and the Pledgor has an obligation to deliver $5 of additional Eligible Collateral by close of business on Day Two. The Parties should consider addressing in the Schedule to the Annex the potential for such conflicting collateral delivery and return obligations through netting or other appropriate mechanisms.

The Annex provides that the Secured Party should calculate the Collateral Value, in part because the Secured Party will likely have an efficient valuation mechanism in place. While the Secured Party will be responsible for determining the amount of excess or deficiency in Collateral, the Secured Party has a duty to perform its calculations in good faith and in a commercially reasonable manner. Thus, in a dispute, the Secured Party's calculation will be controlling, and the Pledgor will be obligated to perform, only if the Secured Party has complied with this duty and absent manifest error in such calculation. See Section 4.1 of the Annex, discussed in Part III.E.1 below.

2. **SECTION 3.2.** Collateral Delivery

On any Business Day, the Secured Party may send notice requiring the Pledgor to deliver additional Eligible Collateral if the Secured Party determines that its Total Exposure exceeds the unsecured Threshold Amount (i.e., that there is a Required Collateral Amount). However, the Pledgor must deliver only if the market value of the Eligible Collateral (after applying applicable Collateral Percentage(s)) necessary to bring the Collateral Value up to the Required Collateral Amount exceeds the Minimum Delivery Amount.

The Secured Party's notice to the Pledgor must be given on a Business Day in the location of the Pledgor's collateral management office. If such day is not a Business Day in the locations of the relevant custodians, delivery of Eligible Collateral is not required of the Pledgor until the next immediate Business Day in the locations of the relevant custodians. For further discussion, see Parts III.D.4 and III.D.6 below. As discussed above, the Annex takes the approach that it is important to require delivery of Eligible Collateral as soon as possible after the mark-to-market value of FX Transactions is calculated. Otherwise, a valuation may reflect spot FX Transactions that already have settled and should become irrelevant to the calculation of Net Exposure arising from the collateralized portfolio.

3. **SECTION 3.3.** Collateral Return

On any Business Day, the Pledgor may send notice requiring the Secured Party to return excess Collateral, if the Secured Party determines that the Collateral Value exceeds the Required Collateral Amount (i.e., the amount by which the Secured Party's Total Exposure has fallen below the Threshold Amount). The Pledgor's notice to the Secured Party must be given on a Business Day in the location of the Secured Party's collateral management office. If such day is not a Business Day in the locations of the relevant custodians, return of Collateral is not required of the Secured Party until the next immediate Business Day in the locations of the relevant custodians. For further discussion, see Parts III.D.4 and III.D.6 below. In acting to fulfill a request for return of excess Collateral, the Secured Party has discretion to select which Collateral to return, which provides flexibility to affect the market sensitivity of the collateral pool.

Certain conditions must be met in order for the Pledgor to demand the return of Collateral. First, the amount demanded must exceed the Minimum Return Amount (after applying applicable Collateral Percentages). Second, no Collateral Annex Event of Default or Event of Default under the Agreement may have occurred or be continuing with respect to the Pledgor. Third, the Pledgor may not be in default in payment or performance under the Agreement, such that the Secured Party has the right to suspend its obligations under the Annex. Fourth, if the performance of the Pledgor under the Agreement has become subject to the Force Majeure, Act of State, Illegality, and Impossibility Provision of the Master Agreement ("Force Majeure Provision"), the Pledgor otherwise would not have failed in payment or performance under the Agreement.

The Force Majeure Provision addresses situations in which a disruption in a local foreign exchange market has made it illegal or impossible for a Party to perform, or has prevented, hindered, or delayed such Party's performance under the Master Agreement. The FX Committee's December, 1999 amendment to the Force Majeure Provision generally provides that, following occurrence of a Force Majeure Event and expiration of a Waiting Period (as defined in such amendment), either Party has the right to require close-out and liquidation of Currency Obligations under any Affected Transactions, without regard to the original Value Dates of the Affected Transactions. As a result, the Pledgor's performance under the Agreement can become subject to the Force Majeure Provision when a local foreign exchange market disruption occurs, even if all of the outstanding FX Transactions with the Secured Party otherwise would have settled outside of the Waiting Period. Under these circumstances, it was determined that the Secured Party should not have the right to withhold excess Collateral unless and until the Pledgor fails to make a payment that has become due (or to fulfill any other obligation under the Agreement).

4. **SECTION 3.4.** Cut-Off Time

The Cut-Off Time, which should be specified in Part VII of the Schedule, is a deadline for receipt of notice that determines whether additional Eligible Collateral must be delivered (or excess Collateral returned) by the close of business on either the same Business Day that notice is provided or the following Business Day. If a Party receives proper notice at or before the Cut-Off Time on a Business Day (in the location of the collateral management office of such Party), such Party must deliver the Eligible Collateral (or return Collateral) before the close of business on that day. If a Party receives proper notice after the Cut-Off Time on a Business Day (in the location of the collateral management office of such Party), such Party has until the close of business on the following Business Day to complete delivery of Eligible Collateral (or return of Collateral).

The Annex provides for expeditious means of providing notice in order to facilitate same-day collateralization. See Section 8.3 of the Annex, discussed in Part III.I.3 below. Nonetheless, the Parties should take factors such as operational capabilities and custodial arrangements into account when designating the Cut-Off Time. If Collateral is held at custodians or subcustodians, the time involved in sending instructions and taking other steps necessary to effect transfers should factor into designation of the Cut-Off Time. It is likely that timing will be particularly critical when forms of Eligible Collateral other than U.S. Dollars and Treasury Securities are permitted under the Annex.

The definition of "Business Day" for the purpose of receiving notice refers to the location of the collateral management office of the receiving Party, but for the purpose of transferring Eligible Collateral (or Collateral) refers to the locations of relevant accounts. See Section 1.1(a) of the Annex, discussed in Part III.A.1 above. If the Parties have decided to use the Annex for pledging of non-U.S. Dollar denominated Collateral, it potentially could be difficult to achieve a Business Day in situations when the Pledgor's custodian is located in a foreign country. Differences in local law or custom may create circumstances in which some offices are legally closed, while others are legally required to be open. For instance, there may be a legal bank holiday in the Pledgor's custodian's jurisdiction due to local law or custom, even though the collateral management offices of both Parties may be open for business, and the Secured Party's custodian may be ready to receive the collateral.

In such a case, delivery would not be required to be completed on a same-day or next-day basis as provided in Section 3.4 of the Annex. Section 5.6 specifies that delivery must be completed by close of business on the next immediate Business Day in the location of all relevant accounts, which in this case would be the location of the Pledgor's custodian (see Part III.F.6 below).

In many situations, the Secured Party and Pledgor may have the resources to arrange for alternative locations for receipt of Collateral and delivery of Eligible Collateral. However, if such accommodation is not possible, the Secured Party can send a notice to the Pledgor but will not be able to require delivery of Eligible Collateral until the Pledgor's custodian's office is open for business. If the foreign exchange markets are open, the position of the Secured Party may rapidly deteriorate while it is forced to wait for a valid Business Day. For this reason, the Secured Party should consider whether it is comfortable with the bank regulatory customs or political risks in the jurisdiction of the Pledgor's custodian. The Secured Party also may wish to incorporate any such potential risks into the Independent Amount.

5. **SECTION 3.5.** Minimum Delivery/Return Amounts

The Minimum Delivery Amount and Minimum Return Amount are both minimum threshold amounts below which Eligible Collateral will not be required to be delivered and Collateral will not be required to be returned, respectively. These threshold amounts should be specified in Part VIII of the Schedule. If not otherwise specified, these amounts will be deemed to be zero.

The Minimum Delivery/Return Amounts may be used to avoid triggering obligations to transfer insignificant amounts of Collateral. These amounts often are related to the relevant Party's credit quality and may be set to vary depending on its credit rating. Once these thresholds are exceeded, however, the Party has an obligation to transfer the full amount due, subject to rounding of uneven amounts if a rounding convention is specified.

Before determining whether the Minimum Delivery/Return Amounts have been triggered, any applicable Collateral Percentages are applied because calls for additional Eligible Collateral or demands for return of Collateral will be based on Collateral Value rather than on actual market value. For example, assume that the Minimum Delivery Amount is $10, Net Exposure is $110, the Independent Amount is zero, and the applicable Collateral Percentages in aggregate result in a 10 percent haircut on the market value of the Collateral pool. If the market value of the Collateral is $110, the Collateral Value is $99 ($110 less 10% of $110), and the Secured Party may make a call for $11 of additional Eligible Collateral. Alternatively, if the market value of the Collateral is $120, the Collateral Value is $108 ($120 less 10% of $120), the Secured Party is undercollateralized by $2 ($110 Net Exposure less $108 Collateral Value). In this case, the Secured Party may not demand transfer of additional Eligible Collateral because the Minimum Delivery Amount is $10.

6. **SECTION 3.6.** Rounding Convention

The Rounding Convention permits the Parties to round collateral deliveries and returns when the amounts required are uneven or impracticable to obtain. In Part IX of the Schedule, the Parties may elect to have both deliveries and returns rounded down, or deliveries rounded up and returns rounded down, by specified increments. If no rounding convention is specified, none will be applied. The Rounding Convention applies only if the amount demanded exceeds any applicable Minimum Delivery Amount or Minimum Return Amount.

E. Section 4. Dispute Resolution

1. **SECTION 4.1.** Dispute Resolution

The dispute resolution provisions of Section 4.1 come into play if the Pledgor disputes a calculation performed by the Secured Party relating to Total Exposure, Collateral Value, or amount of Eligible Collateral to be delivered or Collateral to be returned. The Pledgor must provide the Secured Party with notice of a dispute promptly upon receipt of any notice or other communication from the Secured Party giving rise to the dispute. Pending mutual resolution of the dispute, the Pledgor must continue to perform its obligations under the Annex, absent manifest error in the Secured Party's calculations, and the Parties must confer in good faith in an attempt to resolve the dispute. If the Parties are unable to resolve the dispute, the calculations of the Secured Party are binding, provided the Secured Party has made such calculations in good faith and in a commercially reasonable manner.

The Annex reflects the view that the collateralized foreign exchange market is best served by a simple and efficient dispute resolution mechanism. It is important to have shorter time-frames for resolving disputes, given potentially high volatilities and volumes and the frequency of collateral calls associated with this market. A large portion of FX Transactions are spot transactions that settle on the next or the same day. As a result, the dispute resolution provisions support the requirement that collateral be transferred within the same- to next-day time frame contemplated under the Annex. The Annex's facility for same-day collateral transfers would be meaningless if the Parties were not required to resolve disputes promptly, if possible on a same-day basis. Further, in the foreign exchange markets, prices are likely to be readily available, so that revaluations can be performed promptly with transparent price discovery. Users of the Annex should note that the dispute resolution provisions are designed for use where only one party is obligated to provide collateral, and that issues relating to dispute resolution may differ when both parties are required to provide collateral.

The Annex does not mandate use of specific valuation mechanisms for disputes that may arise over price sources in the event of a market disruption. While a market disruption also might make it more difficult to value Collateral, the Secured Party remains obligated to make calculations in good faith and in a commercially reasonable manner under the circumstances. This approach provides flexibility to arrive at a practicable resolution of a dispute, whereas setting forth rigid criteria for dispute resolution in stressed market situations could prove to be counterproductive. If market quotes are not available, for example, the Secured Party has flexibility to determine that a loss measure is commercially reasonable in light of industry practice and relevant provisions of the Agreement.

In addition, the Annex does not specify how more complex products like barrier options or collateral such as emerging market securities should be valued. More specialized provisions in the Master Agreement and its Schedules, and in related confirmations, would better address valuation issues than the Annex. Accordingly, the Parties should consider whether their documentation adequately addresses valuation and dispute resolution related to more complicated transactions and forms of collateral in order to minimize the possibility of disputes arising under the Annex.

F. Section 5. Other Provisions Relating To Collateral

1. **SECTION 5.1.** Substitutions

The Parties may elect whether to allow substitution of Collateral under the Annex in Part X of the Schedule. If substitution is elected, the Pledgor may, on any Business Day, provide the Secured Party with notice of the items of Collateral to be exchanged. There is no explicit time-frame within which the Pledgor must transfer the substitute Eligible Collateral following provision of notice. However, the Secured Party is not obligated to return the requested Collateral until the close of business on the Business Day (in the location of the collateral management office of the Secured Party) immediately following such transfer. This deadline for the Secured Party's obligation also assumes that relevant custodians are open for business. If this is not the case, as provided in Section 5.6 of the Annex, the Secured Party is not obligated to return the requested Collateral until the next immediate Business Day in the location of each relevant account. Return of the requested Collateral also is not required until the Secured Party has verified that the market value of the substitute Eligible Collateral, after applying applicable Collateral Percentage(s), is equal to that of the Collateral being replaced.

While the Secured Party has up until the close of business on the Business Day following transfer of substitute Eligible Collateral to return requested Collateral, the Secured Party may return requested Collateral on a same-day basis. In some circumstances, the Pledgor may have an immediate need for the requested Collateral. It is anticipated that the Parties will work together to ensure that the substitute Collateral is transferred by a time sufficient to permit the Secured Party to release the requested Collateral on a same-day basis.

2. **SECTION 5.2.** Use of Collateral

Part X of the Schedule enables the Parties to elect whether to allow the Secured Party to sell, pledge, rehypothecate, assign, invest, use, commingle, or otherwise dispose of or use in its business the Collateral. Regardless of whether the Secured Party has exercised any rights with respect to the use of the Collateral, the Collateral is deemed to remain, at all times, pledged to the Secured Party under the Annex. Issues relating to rehypothecation rights are complicated, and Parties should consult with their legal and accounting advisors in determining whether to make elections under Sections 5.1 and 5.2 of the Annex with respect to substitutions and use of Collateral.

3. **SECTION 5.3.** Standard of Care

The standard of care applicable to the Secured Party's custody of the Collateral is one of reasonable care to the extent required by applicable law. This is intended to capture, among other things, the requirement in Section 9-207(1) of the U.C.C., which provides in significant part that a secured party must use reasonable care in the custody and preservation of collateral in its possession.

Section 5.3 further provides that reasonable care will be deemed to have been exercised by the Secured Party if the Secured Party uses at least the same degree of care with respect to the Collateral as it would with respect to its own property. This provision is intended to define what constitutes reasonable care in the safe custody of Collateral under the Annex. Section 1-102(3) of the New York U.C.C. provides that the duty to exercise reasonable care may not be disclaimed by agreement, although under this Section the parties may determine by agreement, in any manner not manifestly unreasonable, what constitutes reasonable care in the particular case. The Parties should consult with their legal counsel regarding the impact of Section 1-102(3) on their business relationship. If the Secured Party fails to exercise reasonable care, there may be a question as to the enforceability of Section 5.3 of the Annex.

While the Secured Party has the duty to exercise reasonable care with respect to the safe custody of Collateral, it has no duty to collect any distributions or to enforce or preserve any rights pertaining to the Collateral. These remain the duties of the Pledgor.

4. **SECTION 5.4.** Interest and Dividends

The Secured Party is entitled to retain any interest or dividend payments on Collateral it has received as additional Collateral. This additional Collateral, however, is net of any applicable deduction or withholding for tax purposes and is subject to the Secured Party's obligation to return excess Collateral to the Pledgor. See Section 3.3 of the Annex, discussed in Part III.D.3 above. Because exposures tend to fluctuate given foreign exchange market volatility, treating interest and dividends as additional Collateral provides for a more efficient means of collateralizing exposures under the Annex while minimizing exchanges of de minimus amounts of collateral between the Parties.

5. **SECTION 5.5.** Earnings on U.S. Dollar Collateral

Part XI of the Schedule allows the Parties to elect whether U.S. Dollar Collateral will be invested by the Secured Party on behalf of the Pledgor. If the election is made, the Secured Party will have the obligation to invest U.S. Dollar Collateral. Earnings arising from such investment will be held by the Secured Party as additional Collateral and are subject to the Secured Party's obligation to return excess Collateral to the Pledgor. See Section 3.3 of the Annex, discussed in Part III.D.3 above. As with interest and dividends, this treatment provides greater efficiency in collateral management.

The Annex does not specify the manner in which U.S. Dollar Collateral must be invested if the Parties so elect, in recognition that there are different market practices. If the Parties elect to require investment of U.S. Dollar Collateral, the mechanisms for investment should be set out in Part XI. In addition, the Secured Party should consider whether to specify in Part XI a required rate of return on such investments or otherwise set out the Secured Party's duty, if any, to earn a certain rate of return for the Pledgor.

6. **SECTION 5.6.** Business Day

Section 5.6 clarifies that any obligation to deliver Eligible Collateral or return Collateral by a certain time under the Annex is subject to there being a Business Day in the locations of all relevant accounts. If this is not the case when a delivery or return is due, the time by which the delivery or return must take place is moved up to the next available Business Day in each of these jurisdictions. This provision is of particular importance if the Annex is used to take forms of Collateral such as non-U.S. Currency and foreign securities. See Parts III.A.1 and III.D.4 above for further discussion.

G. Section 6. Representations And Warranties

1. **SECTION 6.1.** Representations and Warranties

In Section 6.1 of the Annex, the Pledgor makes certain representations and warranties to the Secured Party as of the date of execution of the Annex, any amendments to the Agreement, and any Transactions, as well as of the date of any transfers of Collateral to the Secured Party. Under the Master Agreement, if a representation or warranty is shown to have been materially false or misleading at the time it was made or given (or deemed to be made or given), the other Party may serve notice and, after one Business Day has elapsed, close out and liquidate any outstanding Currency Obligations or Options under the Agreement. See definition of "Event of Default" in Section 1, subpart (viii) of FEOMA, IFEMA, or ICOM. This Event of Default also applies to representations or warranties made or given in the Annex. Any representations, warranties, and covenants made or given in other provisions of the Agreement also apply to the Annex. Such representations, warranties and covenants include those set forth in the Master Agreements. See Sections 7.1 and 7.2 of the FEOMA, Sections 4.1 and 4.2 of the IFEMA, and Sections 7.1 and 7.2 of the ICOM.

H. Section 7. Rights and Remedies

1. **SECTION 7.1.** Events of Default

The occurrence and continuation of an Event of Default or a Collateral Annex Event of Default with respect to the Pledgor entitles the Secured Party to exercise certain rights and remedies under the Annex, in addition to those provided for in the Master Agreement. When close-out netting rights are triggered under the Master Agreement, rights and remedies against Collateral also will be triggered under the Annex, and vice versa. This consistency of result is necessary to ensure that the Secured Party will be able to rely on collateralization on a net mark-to-market basis, as measured under the Master Agreement's Close-Out Netting Provision.

Specifically, occurrence and continuation of an Event of Default under the Master Agreement entitles the Parties to close out and liquidate outstanding Currency Obligations and Options pursuant to its Close-Out Netting Provision. In such a case, Section 7.1 provides that the Secured Party also has the right to liquidate and apply proceeds of Collateral in accordance with Section 7.2 of the Annex. If a Collateral Annex Event of Default is specified in Part VI of the Schedule, its occurrence and continuation would have the same result as an Event of Default under the Master

Agreement and the Annex. This is because occurrence of a Collateral Annex Event of Default also constitutes a failure under a Credit Support Document and thus an Event of Default under the Master Agreement, if such failure continues after the applicable grace period specified in Part VI of the Schedule (if any) has elapsed.

The Master Agreement recognizes the possibility of grace periods for Events of Default arising from failure under a Credit Support Document. Section 7.1(b) clarifies that no grace periods apply to the Pledgor's failure to comply with or perform any agreement or obligation to the Secured Party under the Annex, except for any grace period specified in Part VI of the Schedule with regard to a Collateral Annex Event of Default. As a result, unless otherwise specified in Part VI of the Schedule, there is presumptively no cure period for the Pledgor's failure to timely provide Eligible Collateral under the Annex. It was determined that the Secured Party should have the flexibility to liquidate Collateral in such a case, given the context of market conditions, the financial condition of the Pledgor, and other relevant considerations.

Certain other Events of Default under the Master Agreement specifically pertain to Credit Support Documents and thus the Annex. These generally are: (i) expiration or termination of a Credit Support Document prior to the satisfaction of all obligations of the Defaulting Party, unless this occurs with the written consent of the Secured Party; (ii) disaffirmation, disclaimer or repudiation by the Pledgor or its custodian of all or part of any Credit Support Document; and (iii) any representation or warranty under a Credit Support Document is proven to be materially false or misleading at the time it was made, and one Business Day has elapsed after the Defaulting Party has been provided written notice thereof. See the definition of "Event of Default" in Section 1(xii)(A) of the FEOMA, IFEMA, and ICOM.

Section 7.1(b) of the Annex provides that the Secured Party will attempt in good faith and use reasonable efforts to provide notice of the Pledgor's failure, but not providing such notice will not prejudice the Secured Party's right to proceed against Collateral in accordance with Section 7.2 of the Annex. However, this provision does not alter any obligation a Non-Defaulting Party may have to provide notice to a Defaulting Party in order to exercise close-out netting rights under the Master Agreement. Accordingly, if the Pledgor is a Defaulting Party, it may be expedient for the Secured Party to provide notice of exercise of rights against Collateral to the Pledgor in conjunction with a notice of the Secured Party's exercise of close-out netting rights, if the latter is provided. In such a case, while the notice of exercise of close-out netting rights should be delivered to the Pledgor's Designated Office (specified in Part II of the Schedule to the Master Agreement), the notice of exercise of rights against Collateral should be delivered to the Pledgor's collateral management office (specified in Part XII of the Schedule to the Annex).

2. **SECTION 7.2.** Rights and Remedies

The occurrence and continuation of an Event of Default or a Collateral Annex Event of Default under the Annex entitles the Secured Party to exercise all rights and remedies available under applicable law with respect to the Collateral, including any right of set-off against any obligations the Secured Party may have to the Pledgor. In addition, the Secured Party is entitled to liquidate any Collateral held by the Secured Party at such time.

The Secured Party may want to consider whether it desires to negotiate and put in place a separate arrangement providing for additional means of correcting collateral levels in the event of the Pledgor's failure to perform under the Annex. Such mechanisms are not included in the Annex, because they are not standard and may be used on a one-off basis depending on the specific circumstances. Examples include the right to terminate and close out some but not all Transactions with the Pledgor, to enter into off-setting Transactions with the Pledgor in order to reduce the Secured Party's exposure, or to "top up" collateral. Some secured parties negotiate the concept of a close-out margin level, which is considered a more drastic measure used to gain comfort in dealing with the least creditworthy customers. The close-out margin level is the point at which the amount of the pledgor's mark-to-market loss on transactions exceeds the value of collateral provided. If this level is reached, both close-out netting rights under the Master Agreement and rights against collateral under the collateral agreement are triggered.

3. SECTION 7.3. Notice of Sale

The Parties agree that no notice of sale is required before selling off Collateral in the form of securities, except any notice that cannot be waived under applicable law. Like the provision on notice in Section 7.1 of the Annex, this provision provides the Secured Party the flexibility to liquidate Collateral that may be subject to high price volatility in order to mitigate damages and close-out costs.

4. SECTION 7.4. Proceeds of Liquidation

Once close-out netting has occurred under the Master Agreement, and all amounts payable to the Secured Party by the Pledgor under the Agreement are satisfied through liquidation and application of Collateral, the Secured Party will transfer to the Pledgor any excess Collateral. Excess Collateral may include proceeds of liquidation, any payments of interest or dividends, and any other deliveries received by the Secured Party with respect to such Collateral.

All out-of-pocket expenses incurred by the Non-Defaulting Party, such as fees and disbursements to counsel (including attorneys who may be employees of the Non-Defaulting Party) in connection with any reasonable collection or other enforcement proceedings related to payments required under the Agreement, are reimbursable expenses. See Section 8.6 of the FEOMA, Section 5.6 of the IFEMA, and 8.6 of the ICOM. Accordingly, if the Pledgor is the Defaulting Party, such expenses may be included as amounts payable to the Secured Party by the Pledgor under the Annex. If the Secured Party is the Defaulting Party, such expenses may be included as amounts payable to the Pledgor under the Annex.

Some collateral agreements have expense allocation provisions that deal with situations, for example, where the secured party relends particular collateral, pledgor requests substitution of such collateral, and secured party is unable to obtain such collateral on time. If as a result the pledgor fails on a transaction with a third party, the secured party arguably should be liable for the pledgor's direct losses on the fail. Such a provision was not included in the Annex because it is more common to two-way collateralization arrangements and, furthermore, the pledgor in such a case could make a claim based on breach of contract.

I. Section 8. Miscellaneous

1. **SECTION 8.1.** Confirmation

Section 8.1 permits any additions or revisions to the Schedule to be made using a Confirmation; for example, to permit pledges of additional forms of Eligible Collateral not specified in the Schedule. However, the Master Agreement and the Annex provide that Confirmations cannot be used to modify provisions of the Annex.

2. **SECTION 8.2.** Governing Law

New York law governs the substantive provisions of the Collateral Annex. The law specified in the Master Agreement governs the jurisdiction of the Agreement for purposes of arbitration or litigation. Commercial, bankruptcy/insolvency, and other laws in additional jurisdictions may be relevant to the legal enforceability of the provisions of the Annex, depending on factors including (but not limited to) the locations of the Parties to the Annex, the forms of Collateral that are pledged under the Annex, and the locations of relevant accounts and custodians. Accordingly, practitioners should consider whether, under the circumstances, it would be appropriate to support the legal enforceability of the Annex with a legal opinion that takes into account the laws of all relevant jurisdictions.

3. **SECTION 8.3.** Notices

Section 8.3 provides flexibility to use means of providing any notice required under the Annex within a short time-frame in order to facilitate its same-day and next-day collateral transfer cycles. Presumptively, notice by mail, telex, and facsimile are permitted, and if the Parties so elect in Part XII of the Schedule, they may provide notice by electronic messaging system or E-mail. In the case of E-mail messages, the Parties may want to consider measures such as encryption and digital signatures to help protect their integrity. Unless the Parties agree otherwise, all notices are effective upon receipt.

4. **SECTION 8.4.** Schedule

Parts I, IV, and V of the Schedule to the Annex may be amended or supplemented unilaterally by the Secured Party, effective upon notice to the Pledgor with respect to all outstanding Transactions unless the Secured Party otherwise agrees in writing. These terms relate to Eligible Collateral and Collateral Percentages, the Independent Amount, and the Threshold Amount. The Secured Party is obligated to act in good faith and a commercially reasonable manner in making any adjustments to these terms of collateralization.

5. **SECTION 8.5.** Taxes

Section 8.5 specifies that taxes, assessments, or charges imposed with respect to Collateral are the responsibility of the Pledgor, unless they arise from the Secured Party's sale, repledging, rehypothecation, or other use of Collateral permitted under Section 5.2 of the Annex.

6. **SECTION 8.6.** Termination

Section 8.6 provides that termination of the Annex must be conducted pursuant to the Termination Provision of the Master Agreement, which in turn requires seven days' prior written notice to the other Party, which notice is effective at the end of such seventh day. However, the Collateral Annex will remain in effect until all obligations of the Pledgor to the Secured Party under the Annex have been fully performed. It is important to note that, unlike all other notices required under the Annex, the notice of termination of the Annex should be delivered to a Party's Designated Office in accordance with the terms of the Master Agreement. This exception was made because a Party's collateral management office is more likely to handle ordinary course dealings as opposed to termination of the Annex.

J. The Schedule/Miscellaneous Provisions

The Parties can use the Schedule of the Annex to tailor the Annex to their individual needs. The provisions of the Schedule are addressed above within the discussion of related provisions of the Annex. It should be noted that "Miscellaneous Provisions" of the Master Agreement also apply to the Annex, unless the Annex expressly provides otherwise (see Section 11 of the FEOMA, Section 8 of the IFEMA, and Section 11 of the ICOM).

IV. ADAPTATION TO 1993 IFEMA AND 1992 ICOM

The Annex may be used in conjunction with the 1993 IFEMA and 1992 ICOM, with certain amendments necessary to accommodate these Master Agreements.

To accommodate the 1993 IFEMA, the Annex should be revised as follows:

- Section 1.1(b) is amended to state:

  "Close-Out Netting Provision" means Section 5.1 of the 1993 IFEMA, with Part VI thereof (if applicable).

- Section 1.1(g) (defining "Credit Support Priority Provision") is deleted in its entirety.

- Section 1.1(j) is amended to state:

  "Force Majeure, Act of State, Illegality and Impossibility Provision" means Section 6 of the 1993 IFEMA.

- Section 1.1(s) is amended to state:

  "Set-Off Provision" means Section 5.8 of the 1993 IFEMA.

- Section 1.1(t) is amended to state:

  "Suspension of Obligations Provision" means Section 5.5 of the 1993 IFEMA.

- Section 1.1(u) is amended to state:

  "Termination Provision" means Section 8.6 of the 1993 IFEMA.

To accommodate the 1992 ICOM, the Annex should be revised as follows:

- Section 1.1(b) is amended to state:

  "Close-Out Netting Provision" means Section 8.1 of the 1992 ICOM.

- Section 1.1(g) is amended to state:

  "Credit Support Priority Provision" means Section 11.7 of the 1992 ICOM.

- Section 1.1(j) is amended to state:

> "Force Majeure, Act of State, Illegality and Impossibility Provision" means Section 10 of the 1992 ICOM.

- Section 1.1(s) is amended to state:

  > "Set-Off Provision" means Section 8.6 of the 1992 ICOM.

- Section 1.1(t) is amended to state:

  > "Suspension of Obligations Provision" means Section 8.3 of the 1992 ICOM.

- Section 1.1(u) (defining "Termination Provision") is deleted in its entirety.

- The following definition of the term "Currency" is added as Section 1.1(y) of the Annex:

  > "Currency" means money denominated in the lawful currency of any country or the Euro.

- Section 1.2(a) of the Collateral Annex is amended by replacing the word "In" at the beginning of such section with the words "Notwithstanding Section 11.7 of the Master Agreement, in".

- Section 8.6 is amended to state:

  > Each of the Parties may terminate this Collateral Annex at any time by seven days' prior written notice to the other Party delivered as prescribed in Section 11.2 of the Master Agreement, and termination shall be effective on the end of such seventh day; provided, however, that the provisions of this Collateral Annex shall continue to apply until all the obligations of each Party to the other under the Agreement have been fully performed.