IRREVOCABLE STANDBY LETTER OF CREDIT PROVISIONS TO PARAGRAPH 13 OF THE ISDA® 2016 CREDIT SUPPORT ANNEX FOR VARIATION MARGIN (VM)

Note to User: This document provides a list of recommended elections and/or changes for users to make to Paragraph 13 of the ISDA® 2016 Credit Support Annex for Variation Margin ("CSA VM") when using the IECA Irrevocable Standby Letter of Credit Form. The CSA VM was designed to comply with margin rules for non-cleared derivatives[1] established by certain regulatory authorities. One of the regulatory-compliant aspects of the CSA VM is a built-in limitation on types of margin that may be transferred. Under the US rules, eligible margin types do not include letters of credit.[2] However, there are potential situations where the use of the CSA VM with letters of credit would not be inappropriate, e.g., (1) the parties to certain regulatory-compliant margining arrangements wish to provide credit support in excess of regulatory requirements (and they contemplate including letters of credit in such excess), or (2) a party is exempt[3] from margin rules but still wishes to exchange margin with another party who has a preference for using the CSA VM form. Please note that the Paragraph 13 sub-paragraph references in this document are intended as a guide only and may vary as Paragraph 13 is customized for specific business purposes.

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[1] *See ISDA Publishes Margin-Rule-Compliant Collateral Document*, International Swaps and Derivatives Association, Inc. (Apr. 13, 2016), avail. at http://www2.isda.org/news/isda-publishes-margin-rule-compliant-collateral-document .

[2] *See Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants; Final rule and interim final rule*, 81 Fed. Reg. 636, 701-702 (Jan. 6, 2016), avail. at https://www.gpo.gov/fdsys/pkg/FR-2016-01-06/pdf/2015-32320.pdf ("CFTC Rulemaking") § 23.156 (Forms of margin); *Margin and Capital Requirements for Covered Swap Entities; Final rule*, 80 Fed. Reg. 74840, 74903-74905 (Nov. 30, 2015) avail. at https://www.gpo.gov/fdsys/pkg/FR-2015-11-30/pdf/2015-28671.pdf ("Prudential Regulators Rulemaking") § __.6 (Eligible collateral).

[3] Section 302 of the Business Risk Mitigation and Price Stabilization Act of 2015 (BRMPSA), Pub. L. 114-1, Title III, 129 Stat. 28 (Jan. 12, 2015), avail. at https://www.gpo.gov/fdsys/pkg/PLAW-114publ1/pdf/PLAW-114publ1.pdf#page=26 , which is included as Title III to the Terrorism Risk Insurance Program Reauthorization Act of 2015 (TRIPRA), amends the Dodd-Frank Act (DFA), Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111 -203, 124 Stat. 1376 (2010), such that certain non-financial hedging entities, certain cooperatives, and certain financial entities who perform a hedging function for affiliates are exempt from margin rules that the DFA otherwise requires regulators to apply to non-cleared swaps traded by certain entities. *See* Commodity Exchange Act (CEA) §2(h)(7)(A), 7 U.S.C. 2(h)(7)(A)(certain non-financial hedging entities); CEA §4(c)(1), 7 U.S.C. 6(c)(1) and CFTC Regulation at 17 C.F.R. §50.51 (public interest and certain cooperatives); CEA §2(h)(7)(D), 7 U.S.C. 2(h)(7)(D) (as relates to certain financial entities who perform a hedging function for affiliates). *See also* Prudential Regulators Rulemaking, *supra*, at 74848 (referring to TRIPRA, states that it "amends sections 731 and 764 of the Dodd-Frank Act to exempt certain transactions of certain financial and nonfinancial end users from the Agencies' margin requirements...").

Paragraph 13.

1. **Credit Support Obligations.** Recommended elections for Paragraph 13(c)(ii) and (vi):

(ii) ***Eligible Collateral (VM)***. Subject to Paragraph 11(g), if applicable, and each Credit Support Eligibility Condition (VM) applicable to it specified in Paragraph 13, if any, the following items qualify as *"Eligible Collateral (VM)"* for the party specified (as the Pledgor):

	Party A	Valuation Percentage	Party B	Valuation Percentage
(A) Cash in an Eligible Currency[4]	[X]	[100%]	[X]	[100%]

(vi) ***Other Eligible Support (VM).*** The following items will qualify as "***Other Eligible Support (VM)"*** for the party specified (as the Pledgor):

	Party A	Party B	Valuation Percentage
(A) Letter(s) of Credit	[X]	[X]	[*]

*100% of the Value of the Other Eligible Support (VM), except 0% for a Letter of Credit with respect to which a Letter of Credit Default has occurred.

2. **Dispute Resolution.** Recommended language for Paragraph 13(g)(ii) and (iv):

(ii) ***Value***. For the purposes of Paragraphs 5(iv)(A)(3) and 5(iv)(B), the Value of Posted Credit Support (VM) will be calculated as follows:

(A) with respect to any Cash posted as Posted Credit Support (VM), the face amount of such Cash; and

(B) with respect to any Letter of Credit posted as Posted Credit Support (VM), as specified in this Annex.

(iv) ***Resolution of Calculations***. Paragraph 5(iv)(A)(2) of this Annex is amended by replacing the words "then the Valuation Agent's original calculations will be used for that Covered Transaction;" with the words "the parties will appoint a mutually acceptable third party to make such determination as substitute Valuation Agent. The cost of the substitute Valuation Agent will be borne equally by the parties."[5]

[4] "Cash" is defined in Para 12.

[5] Typical energy industry forms provide that where a Valuation Date is every Local Business Day and the Valuation Agent is the party making the demand, each party is allowed to ask for collateral based on the valuation it assigns the position based on quotes it obtains. If a party cannot get quotes on positions, there is a mechanism in the ISDA® 2016 Credit Support Annex for Variation Margin by which fewer quotes are needed. Reverting to the Valuation Agent's number means that if the party asking for collateral cannot get quotes, the parties go by the requesting party's original number. This means that the next day, when the other party is the Valuation Agent now asking for

3. Other Eligible Support (VM) and Other Posted Support (VM). Recommended language for Paragraph 13(l):

(i) ***"Value"*** with respect to Other Eligible Support (VM) and Other Posted Support (VM) means: (A) the stated amount (of any Letter of Credit undrawn and available to be drawn by Secured Party) multiplied by (B) the applicable Valuation Percentage.

(ii) ***"Transfer"*** with respect to Other Eligible Support (VM) and Other Posted Support (VM) means: For purposes of Paragraph 3(a), delivery of the Letter of Credit, or notice or amendment extending the term or increasing the amount available thereunder by its Pledgor or Issuer to Secured Party at its Address for Transfers; and for purposes of Paragraph 3(b), by the return of the Letter of Credit by Secured Party to Pledgor, at its Address for Transfers, or delivery of an executed amendment reducing the amount available thereunder to Pledgor at its address for Transfers. If a Transfer is to be effected by a reduction in the amount of a Letter of Credit, Secured Party will timely take such action as is reasonably necessary to effectuate such reduction.

(iii) ***Letter of Credit Provisions***.

(A) Letters of Credit must meet the requirements of this Annex and be for the benefit of Secured Party. Pledgor of each Letter of Credit must: (i) renew or cause the renewal of each Letter of Credit at least twenty (20) Local Business Days[6] before the Letter of Credit expires; and (ii) if the Issuer (a) has indicated its intent not to renew or substitute such Letter of Credit at least twenty (20) Local Business Days before its expiration or (b) fails to honor Secured Party's proper draw request, then in either event Pledgor must within one Local Business Day provide: (x) a substitute Letter of Credit issued by a different Qualified Institution; or (y) post Eligible Credit Support (VM).

(B) As one method of providing Eligible Credit Support (VM), Pledgor may increase the amount of a Letter of Credit or establish one or more additional Letters of Credit.

(C) A Letter of Credit must provide that Secured Party may draw upon it up to its entire undrawn portion. Without limiting any rights of Secured Party under the Agreement or the Letter of Credit, or extending any other deadlines hereunder with respect to the downgrade of an Issuer or otherwise, if Pledgor fails to within at least twenty (20) Local Business Days prior to the expiration of the Letter of Credit, renew, substitute, or otherwise timely sufficiently increase the amount of a Letter of Credit, or otherwise provide sufficient Eligible Credit Support (VM), then Secured Party may draw on the entire, undrawn portion of any Letter of Credit.

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collateral for its demand, the parties use that number, and then that number will prevail, and the disputed mark goes back and forth for the life of the swap. This provision avoids that ping-ponging by providing for a dispute resolution by a third party, which could be another dealer, chosen as a neutral. Dodd-Frank regulations at 4(i) in column 1 of 77 F.R. 55964 may require swap dealers to provide this provision to an end user if it is requested, although some swap dealers disagree and believe that the swap dealer is only required to provide an alternative method, and that a permissible alternative method is the original one by which the requesting party gets its number. The CFTC in this rulemaking responded to a specific comment on this issue by the IECA. See 77 F.R. 55909 cols. 2 and 3.

[6] Letters of Credit may provide for a drawing condition for failure to renew; if using this provision Secured Party should seek to require this as a drawing condition. The time periods in Paragraph 13 and the Letter of Credit should match and be calendared. 30 calendar days is also commonly seen in this provision.

Pledgor shall remain liable for any amounts due and owing to Secured Party and remaining unpaid after the application of the amounts so drawn by Secured Party. All Cash received therefrom not otherwise applied to obligations of Pledgor shall be Posted Collateral (VM) in the form of Cash.

(D) Upon the occurrence of a Letter of Credit Default, Pledgor must deliver a substitute Letter of Credit or other Eligible Credit Support (VM) to Secured Party in an amount at least equal to that of the Letter of Credit to be replaced on or before the first Local Business Day after written demand by Secured Party (or the third Local Business Day if only clause (i) under the definition of Letter of Credit Default applies).

(iv) ***Certain Rights and Remedies***.

(A) ***Secured Party's Rights and Remedies***. For purposes of Paragraph 8(a)(ii), Secured Party may draw on any Letter of Credit in an amount equal to any amounts payable by Pledgor with respect to any Obligations.

(B) ***Pledgor's Rights and Remedies***. For purposes of Paragraph 8(b)(ii): Secured Party is obligated immediately to Transfer any Letter of Credit to Pledgor and without limiting Pledgor's rights under the Agreement, until Secured Party does so, Pledgor may set off any amounts payable by Pledgor with respect to any Obligations, withhold payment of any remaining amounts payable by Pledgor, up to the Value of such Letter of Credit.

4. Other Provisions / Additional Definitions. Below are some recommended definitions to include in the list of other provisions / additional definitions in Paragraph 13:

(i) ***Events of Default***. Paragraph 7 is amended by replacing "Eligible Collateral (VM), Posted Collateral (VM)" in the first and second lines of (i) with "Eligible Credit Support (VM), Posted Credit Support (VM)".

(ii) ***"Credit Rating"*** means, with respect to any entity, the rating then assigned to such entity's unsecured, senior long-term debt obligations not supported by third party credit enhancements by S&P or Moody's, or if such entity does not have a rating for its senior unsecured long-term debt obligations, then the entity's issuer credit rating assigned by S&P or Moody's.

(iii) ***"Issuer"*** means the issuer of the Letter of Credit.

(iv) ***"Letter of Credit"*** means an irrevocable, standby letter of credit, issued by a Qualified Institution acceptable in both form and substance to Secured Party and meeting the requirements of this Annex.

(v) ***"Letter of Credit Default"*** means with respect to a Letter of Credit, the occurrence of any of the following: (i) the Issuer fails to be a Qualified Institution, (ii) the Issuer fails to comply with or perform its obligations under such Letter of Credit if such failure continues after the lapse of any applicable grace period; (iii) the Issuer disaffirms, disclaims, repudiates or rejects, in whole or in part, or challenge the validity of, such Letter of Credit, (iv) such Letter of Credit expires or terminates, or fails or ceases to be in full force and effect at any time during the term of any outstanding Transaction; (v) twenty (20) or fewer Local Business Days remain prior to the date such Letter of Credit shall expire; or (vi) any event analogous to an event specified in Section 5(a)(vii) of the Agreement occurs with respect to the Issuer; provided, however, that no Letter of Credit Default occurs with respect to a Letter of Credit that is required to be returned to Pledgor under this Annex.

(vi) ***"Moody's"*** means Moody's Investor Services, Inc., or any successor that is a nationally recognized statistical rating organization.

(vii) ***"Qualified Institution"*** means a major U.S. [or Canadian] commercial bank or a U.S. [or Canadian] branch of a foreign bank having an asset base of at least $10 billion, with such bank having a Credit Rating of at least "A-" by S&P or "A3" by Moody's.

(viii) ***"S&P"*** means S&P Global Ratings, or any successor that is a nationally recognized statistical rating organization.