

Legal Representation of Public Pension Plans in Negotiating Repo and Reverse Repo Agreements

Overall Philosophy

Representing public pension plans on Repo and Reverse Repo Agreements reverses the typical position of the parties. Typically, when a bank negotiates a repo agreement (e.g., with a corporate counterparty), the bank is financially more solid than its counterparty, and so it seeks enhanced protections against issues involving the counterparty. However, when the counterparty is a public pension fund, the counterparty is typically more financially sound than the bank, turning the tables on which party needs protection from the other's potential inability to perform.

Reinhart Experience

Reinhart's experience in Repo Agreements is ongoing and supplements our main public pension practice that focus on partnership investments. On average, we represent public pension plans on repo (and related: ISDA) agreements one or two times a year. Currently, we are representing a West Coast public pension plan in a repo negotiation with RBC. Jussi Snellman (shareholder) and Woomin Kang (senior associate) would be the attorneys most likely to work on Repo Agreements.

Structure of Repo Agreements

Repo participants use a preprinted form Master Repurchase Agreement (MRA) from 1996 as the foundational document. The terms in the MRA are modified using Annex I to the MRA ... so all the negotiation happens in the context of Annex I.

Key Negotiated Items for Repo Agreement Annex I

Key items that a public pension plan would wish to include in "Annex I" to the MRA include the following:

1. Obligation to Deliver Financial Reports. Public pension plans typically limit their own obligation to deliver financial reports to *publicly available* financial reports (while not similarly curtailing the bank's obligation to deliver financial reports).
2. Margin Deficit Thresholds. The parties typically use a minimum threshold, before cash transfers and true-ups are needed to balance margin deficits that arise due to changing market values of collateral. While a smaller threshold can better protect from counterparty default, we have seen public pension funds and banks settle on \$250,000 (or less).
3. Description of Permitted Securities. It would be advisable to limit the Agreement to the securities that the public pension plan is authorized to use for the repos. (e.g., U.S. Treasury securities.)

4. Unique Terms for Public Pension Funds.
 - a. Sovereign Immunity. Public pension funds and banks often seek to include a fairly customary sovereign immunity provision, which (a) recognizes the fact that there is sovereign immunity; and (b) contains a commitment by the pension fund to adhere to the contractual terms and not rely on a sovereign immunity defense to them.
 - b. Waiver of Jury Trial. Banks often request that no jury be involved in litigating any disputes. The public pension fund response to this term depends on its policy position on jury trial waivers.
 - c. Public Records / Disclosure. Public pension funds need to be sure they can adequately follow the law, and disclose items required to be disclosed under applicable public records laws.
 - d. ERISA. Public pension plans typically seek to eliminate or modify the ERISA representation, as they are not subject to the fiduciary standards contained in Title I of ERISA.
5. Default Triggers. Banks sometimes like to modify the default triggers in the MRA, but we find that public pension funds prefer the MRA's default remedies (including, by way of example, immediate deemed default in the event of an insolvency of a counterparty or its affiliates). An additional term that is often desirable is one clarifying that an operational hiccup that is promptly remedied (by 2:00 p.m. on the next business day) does not constitute an Event of Default.
6. Insolvency, liquidation and bankruptcy.
 - a. Basic Protection via Collateral. Counterparty exposure in the event of insolvency is significantly reduced, as the parties swap cash and a roughly equivalent amount of assets. Thus, the insolvency or bankruptcy of one counterparty would not result in a material loss to the other counterparty.
 - b. Annex I terms related to Insolvency. We typically like to include the following provisions in Annex I to address the pension plan's rights in the event of a counterparty insolvency. (Note also that banks are "bankruptcy-remote" entities, not entitled to take advantage of the bankruptcy laws. Instead, insolvent banks are subject to a special resolution overseen by the FDIC, which may serve as the insolvent bank's conservator or receiver.)
 - i. Immediate Default Upon Insolvency. The MRA provides for immediate deemed default in the event of insolvency of a counterparty. Sometimes banks request a different (less automatic) default provision via Annex I, but we have historically objected to such terms (with success).
 - ii. Insolvency of Bank Affiliate. We seek to limit the ability of Party A (the bank) to avoid default if one of its affiliates becomes insolvent. We like to

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clarify that credit enhancements by the bank's affiliates are unaffected by the affiliate's bankruptcy. Also, we seek to define "affiliate" in a way that would nonetheless trigger a default if the bank's holding company is the affiliated entity that becomes insolvent.

- iii. Bank Receiver/Conservator as Default. We like to include the appointment of a conservator or receiver as an insolvency event (which also triggers default). While not all repo agreements contain this provision, having one can help speed up the default remedies in the event of bank insolvency. However, automatic stays under federal law are likely to apply in the event the FDIC takes over as receiver for a bank, and those stays take precedence over contractual rights.

7. Additional "Annex Terms". Banks do not always include the following provisions in the Annex I, although they are typically desirable (in some cases, mutually desirable, and in other cases more desirable for the public pension plan than the bank):

- a. Fail Charge Trading Practices – Specifying that the published Fail Charge Trading Practice will be followed.
- b. Confirmations – Providing detail regarding how confirmations may be sent, and including an objection deadline.
- c. Representation regarding absence of liens.
- d. Prohibition on sale, transfer or hypothecation of the pledged securities
- e. Delivery Fail (mini-closeout provision)
- f. Good faith and commercial reasonableness obligations