Commentary on the ISDA Master Agreements

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This memorandum is intended as an introduction to the 1992 (Multicurrency-Cross Border) Master Agreement (the "1992 Agreement") and the ISDA 2002 Master Agreement (the "2002 Agreement" and, together with the 1992 Agreement, the "Master Agreements"). The Master Agreements are published by the International Swaps & Derivatives Association, Inc. ("ISDA").

This document is not intended as a comprehensive review nor as a recommendation that a particular type of agreement is or is not suitable for particular transactions. The commentary is based on the 1992 Agreement and where applicable, key differences in the 2002 Agreement are referenced. Detailed commentaries on the Master Agreements can be found in the User's Guides to the 1992 Agreement and 2002 Agreement published by ISDA.

Defined terms have the meaning given to them in the Master Agreements.

If you require further advice, please see the contact details on the back of this paper.

General

ISDA Documentation

ISDA has developed standard terms on which parties can document a wide range of over-the-counter (OTC) derivatives transactions.

The Master Agreements may be used to document a wide range of derivative transactions. A list of transactions commonly documented under them are set out in Annex 1.

Master Agreements

The Master Agreements are designed, amongst other things, to facilitate cross-transaction payment and close-out netting and provide standardisation of terms which are no-transaction specific. They each contain certain fundamental standard terms which provide transaction linkage together with a menu of standard terms which parties can select or disapply certain matters such as payment netting, events of default and other events entitling a party to call for early termination and to specify details for matter such as transfers and notices.

The 1992 Agreement
At the core of the ISDA documentation framework is the 1992 Agreement. There is also a Local Currency – Single Jurisdiction version of the 1992 ISDA Master Agreement

The **Local Currency - Single Jurisdiction** version is intended for transactions involving parties in the same jurisdiction and a single currency. It is of rather limited use, in that even if parties within a single jurisdiction enter into single currency transactions in the first instance, they may later decide to widen the scope of their transactions and find the agreement inappropriate.

The **Multicurrency - Cross Border** version is the most versatile, and - although it can, of course, be used between parties in the same jurisdiction for transactions involving a single currency - has been particularly designed to cater for transactions which are entered into between parties in different jurisdictions and/or which involve more than one currency. It is this agreement which is most commonly used and on which this memorandum concentrates.

The 2002 Agreement
The 2002 Agreement updates the 1992 Agreement and includes certain new provisions. The 2002 Agreement, as with the 1992 Agreement, caters for transactions entered into between parties in different jurisdictions and/or which involve more than one currency.

In brief the key changes which have been made are:

a. providing for Force Majeure as a new Termination Event;
b. providing a new methodology for close-out calculations;
c. reducing the grace period for the Failure to Pay or Deliver Event of Default from 3 to 1 Local Business Days;

d. some hardening of the Bankruptcy Event of Default;
e. expansion of Breach of Agreement Event of Default to include repudiation;
f. expanding the definition of Specified Transaction for the purposes of the Default under Specified Transaction Event of Default to include, amongst other things, stock lending and repo;
g. combining the two limbs in the Cross Default Event of Default in determining whether the Threshold has been reached;
h. including, as standard, a set-off provision (see Section 6(f));
i. providing revised and consolidated interest and compensation provisions (see Section 9).

The list above is illustrative of several of the key changes to the 1992 Agreement, and is not exhaustive nor is it intended to be a legal analysis of the documents. As well as these new provisions, various provisions have also been amended. ISDA have produced a blacklined version of the 2002 Agreement which shows the changes from the 1992 Agreement.

Whilst the 1992 Agreement is still being used predominantly in the market-place, the 2002 Agreement is increasingly being used, particularly in the end user side of the market and users should familiarise themselves with the new terms.

Schedule

The Master Agreements are standard printed forms and do not of themselves constitute workable agreements. Many of the provisions are optional and need to be selected by the parties in order to apply. To do this it is necessary to complete a “Schedule” tailoring the agreement to the particular parties. Within the body of the Schedule the parties can alter or amend the provisions of the printed form as they wish, both by selecting between alternative provisions (for example, on the method of calculating close-out payments or the applicable governing law) and by adding provisions of their own (or, indeed, disapplying any of the standard provisions).

The Schedule can be completed as it stands. However, it is customary - and generally more convenient - for the Schedule to be retyped. This is perfectly unobjectionable. **It is, however, strongly recommended that the main body of each of the Master Agreements - i.e. the standard terms preceding the Schedule - is never retyped or altered.** The advantage of standardisation is lost if it is not clear whether provisions of the standard forms have been changed.

Confirmations and Definitions

A Master Agreement and Schedule together provide a framework for derivatives transactions between two parties. They do not, however, set out the terms (in particular the financial/pricing terms) of individual deals. For this, the parties need to exchange a Confirmation setting out the particular commercial terms.

ISDA has produced a number of different forms of pro forma Confirmation suited to different types of transactions, and a number of definitional booklets providing standard terms for inclusion in such confirmations and establishing the basis for such matters as rate fixing, calculations and so on.

Collateral agreements

The intrinsic value of swap transactions may vary from day to day as the markets fluctuate.

It is increasingly common for parties to mark transactions to market on a regular basis and to seek to collateralise if their exposure passes certain thresholds. There are a number of reasons for this. In particular, a party may be motivated by a concern to maximise lines of credit from new or existing counterparties, to reduce credit risk, to reduce capital maintenance requirements or to meet regulatory concerns (institutions regulated by the Financial Services Authority (FSA), for example, are required by the FSA Rules to mark transactions to market daily).

There are a number of ways in which this can be done, and in an attempt to introduce market standardisation ISDA have produced four agreements intended to assist with the establishment of bilateral mark-to-market security arrangements. These are:

- The **1994 Credit Support Annex (Security Interest – New York Law),** which has an accompanying User’s Guide. It is governed by, and is intended for use with, agreements subject to New York law and takes the form of an annex which, when adopted, forms part of the master agreement itself. It requires cash and/or securities to be pledged by one party to the other if the amount of exposure requires this, and operates by creating a security interest.

- The **1995 Credit Support Annex (Transfer – English Law).** This is governed by English law and rather than creating a security interest in the collateral, it requires an outright transfer of cash and/or securities. As with the New York law CSA, it forms part of the main master agreement when adopted.
- The **1995 Credit Support Deed (Security Interest – English Law).** This is an English law document which operates by way of creation of a security interest in cash and/or securities. It is a stand-alone document and is likely to require registration at the Companies Registry under UK companies legislation. For this reason (amongst others) it is not widely used.

  There is also a User's Guide for the two English law credit support documents.

- The **1995 Credit Support Annex (Japanese Law).** This document is only used where the parties intend to use assets located in Japan as credit support. Due to its limited scope, it is not considered further in this memorandum. There is a User's Guide accompanying this document.

All four forms of collateral agreement are intended for use in bilateral mark-to-market arrangements. However, they can readily be adapted to provide for one-way arrangements (where only one of the parties is required to put up security or transfer assets).

They were each drafted with the 1992 Agreement in mind and need to be amended for use with a 2002 Agreement. This can easily be done by incorporation of the 2002 Master Agreement Protocol which contains the necessary changes.

Termination and close-out netting

One of the biggest advantages of the Master Agreements is the ability of the parties to terminate all outstanding transactions if certain specified events (called Events of Default and Termination Events in the Master Agreements) occur in relation to one of the parties. Such a termination of all transactions is known as a close-out.

When a close-out occurs the Master Agreements provide a mechanism for the calculation of the present value (or termination cost) of all obligations in respect of outstanding transactions and the calculation of a single net obligation of one party to make a payment to the other in respect of all such obligations. (The termination and close-out netting provisions of the 1992 Agreement are considered in more detail in Section 2 below.)

These termination and close-out provisions enable parties significantly to reduce their exposure to the other party for credit and capital adequacy purposes.

Capital adequacy and netting

For capital adequacy purposes, regulators in most countries permit banks and other financial institutions to use net exposures for capital adequacy purposes where the relevant bank or other institution has an effective netting agreement in place.

There are several requirements which normally need to be met before a bank or other financial institution can use close-out netting provisions in an agreement as an effective means of reducing credit exposures. These requirements were originally based on the July 1994 Amendment to the Capital Accord of July 1988 adopted by the Basel Committee on Banking Supervision (part of the Bank for International Settlements). The update to the 1998 Accord ("Basel II") has now been published by the Basel Committee and was implemented in the end of 2007. For the consolidated text of Basel II, see the International Convergence of Capital Measurement and Capital Standards published by the Basel Committee in June 2006.

The requirements for an "effective netting agreement" under the 1998 Accord and Basel II are broadly the same and include the following:

a. The party seeking to rely on the netting agreement for capital adequacy purposes must hold reasoned legal opinions on the enforceability of the close-out netting provisions in each relevant jurisdiction.

   In this regard, ISDA have commissioned numerous legal opinions on the enforceability of these provisions. In particular, opinions have been obtained:

   - as to the enforceability of these provisions under English law and New York law (which are the laws which the parties can select to govern the Master Agreements); and
   - as to the enforceability of these provisions in the event of the insolvency of one of the parties organised and/or acting through a branch in various jurisdictions.

   The legal opinions are addressed to ISDA and may be relied upon by members of ISDA.

ISDA has also obtained legal opinions from lawyers in many of these jurisdictions on the English and New York law credit support documents.

b. The netting agreement must not contain a “walk-away” clause - i.e. a clause which permits a non-defaulting party not to pay a net sum which it may be obliged to pay to a defaulting party on early termination after the close-out netting calculation has been made.

   The 1992 Agreement provides for parties to select either the “First Method” or the “Second Method” of paying the termination payment. The First Method is in effect a “walk-away” clause and parties should elect the Second Method in order to be permitted to report exposures on a net basis for capital adequacy purposes. The 2002 Agreement has no such election and Second Method is effectively embedded.

Commentary on Printed Terms

Please note that references to Sections refer to sections of the 1992 Agreement.

The effective date and names of the parties need to be added. The insertion of this information, together with the names of the parties in the signature blocks, are the only amendments that should be made to the pre-printed terms.

It is often the case that parties enter into Transactions prior to signing the Master Agreement. For this reason, the Master Agreement is expressed to be “Dated **as of** ...” rather than “Dated …”. This wording means that a Master Agreement can be expressed to take effect from a date before the date on which it is actually signed. This is also reflected in the execution wording on page 18, which envisages signing taking place on one date but the agreement having effect from another. In practice the trade date of the first Transaction is generally chosen unless the agreement is signed before any Transactions have been entered into.

Where Transactions are entered into before the Master Agreement is signed, the market practice for drafting confirmations is to refer to a Master Agreement the parties intend to execute, and until such is executed, deem the existence of a Master Agreement with no Schedule but just the basic and essential stated elections sufficient for the Master Agreement to function as a legal document. At a minimum, this must include the designation of: (i) the choice of law; and(ii) the Termination Currency.

Preamble

This establishes the framework and makes clear that Transactions to be governed by the agreement are subject to the printed terms, the Schedule and any confirming evidence (“Confirmations”) exchanged.

“Transaction” is not specifically defined. The intention is that the Master Agreement should be capable of use (with modifications, if necessary, in the Confirmations) for whatever derivative transactions the parties choose. Where the Master Agreement is intended to apply, this should be specified in the relevant Confirmation unless the parties have agreed to another way of defining the transactions of a particular type are to be treated as Transactions under the Master Agreement between them. A list of transactions which ISDA specifically contemplates being entered into under the Master Agreement is comprised in Annex 1.

Section 1 - Interpretation

a. Terms defined in Section 14 and the Schedule are to apply to the Master Agreement.
   The applicable ISDA Definition booklet is also likely to be incorporated into each Confirmation, and (as a result) these too will be incorporated into the Master Agreement, since they form part of the same agreement (see Section 1(c)).

   Where ISDA Definitions (e.g. the 2006 ISDA Definitions for interest rate derivatives) are to be incorporated into Confirmations, it is not uncommon also to incorporate these in the Schedule. It is, however, preferable to deal with them in Confirmations only as the Definitions are updated from time to time and it is important to be clear which edition applies to a particular Transaction.

b. Where there are discrepancies, the Schedule prevails over the printed terms of the Master Agreement, and, for a particular Transaction, the relevant Confirmation over the printed terms and Schedule. Therefore it is possible to vary the standard terms either for all Transactions between the parties (by introducing changes to the printed terms in the Schedule), or for a particular Transaction (by the provisions of the relevant Confirmation).

c. The Master Agreement and all Confirmations are expressly stated to form a single agreement and it is made clear that the parties are only entering into Transactions on this basis. In a number of jurisdictions this provision may be essential if close-out netting under the Master Agreement is to work.

Section 2 - Obligations

a. Section 2(a) obliges the parties to make the payments or physical deliveries specified in the Confirmations which the parties exchange for particular Transactions.

   Payments and deliveries are conditional upon no Event of Default or Potential Event of Default with respect to the other party having occurred and continuing and upon no Early Termination Date for the relevant Transaction having occurred or been effectively designated. “Event of Default” is defined in Section 5 and “Potential Event of Default” (an event which, with notice or the lapse of time, would constitute an Event of Default) in Section 14. Again, in some jurisdictions this Section can be important for close-out netting to be effective. Although the Master Agreements contain the principal provisions necessary to deal with payments, for Transactions settled by physical delivery further provisions may be required. A number of suggestions are set out in Section VI (page 61) of the ISDA User’s Guide to the 1992 Master Agreement.

b. Accounts for payments or deliveries may be changed on five “Local Business Days” notice (“Local Business Days” being defined in Section 14) unless the other party gives “timely notice” of a “reasonable objection”.

   It is not uncommon for the Schedule to limit this right, for example to prevent changes of jurisdiction without consent.

c. Payments due on the same date in the same currency in respect of the same Transaction will be netted.

   The parties can, by modifying this provision, also agree that netting of same currency payments due on the same date is to apply across all Transactions, or across particular groups of Transactions between particular offices. This amendment, however, is not always made since some market participants lack the appropriate systems capability to deal with such cross-transactional payment netting.

d. Payments are to be made without deductions or withholdings on account of tax unless a deduction or withholding is required by law. Where a deduction or withholding is required, the affected payment is to be grossed up, **provided that:**

   - the relevant tax is an “Indemnifiable Tax” (see Section 14) - essentially any tax imposed on a payment **other than** a tax imposed because of a connection between the taxing jurisdiction and the recipient of the payment or a related person;
   - the recipient has not failed to provide any tax forms or documents required under Section 4 (a)(i) or (iii), or to notify the payer under Section 4(d) of any relevant change of its tax status; and
   - no payee tax representation given by the recipient is incorrect other than as a result of action by a taxing authority or court proceedings on or after the date a Transaction is entered into or as a result of a change in tax law.

   Under Section 2(d)(ii), where a party fails to make a deduction or withholding from a payment which it is required by law to make and for which it is not required to gross up, then the other party must indemnify it against any tax liability which it incurs as a result, with the exception (if the indemnifying party has complied with its tax agreements under the Master Agreement) of any penalties.

e. Default interest is payable under this Section on defaulted payment obligations, up until the occurrence or effective designation of an Early Termination Date, after which interest is payable under Section 6(d)(ii). In the case of defaults in deliveries compensation is payable only if the Schedule or Confirmation provides. This has changed under the 2002 Agreement.

Section 3 - Representations

The representations set out in this Section are repeated by each party on each date on which a Transaction is entered into and, in the case of the payee tax representations (Section 3(f)), at all times while the Master Agreement is in force.

a. **Basic representations**
   These are self-explanatory and cover the following basic matters:

- a party's status, powers, confirmation that execution of the Master Agreement will not violate or conflict with applicable laws, constitutional documents, orders, judgments, contractual restrictions, etc
- the obtaining of any necessary governmental or other consents for the Master Agreement or any "Credit Support Document" (i.e. collateral agreement, guarantee, etc) to which it is a party
- the binding nature of a party's obligations under the Master Agreement and any Credit Support Document

b. **Absence of certain events**
Each party is required to represent that no actual or potential Event of Default or Termination Event has occurred and is continuing or will occur as a result of entry or performance of the Master Agreement or any Credit Support Document to which it is a party.

c. **Absence of litigation**
Each party represents that there is no actual or pending litigation against it or an Affiliate likely to affect the legality, validity or enforceability against it of the Master Agreement or any Credit Support Document to which it is a party or its ability to perform under the Master Agreement or such Credit Support Document.

Some institutions are not comfortable giving this representation as regards all Affiliates and seek to reduce the scope of the representation.

d. **Accuracy of specified information**
Each party represents that all written information identified in the Schedule as being subject to representation 3(d) is, as of the date of that information, true, accurate and complete in every material respect. It is important to specify that this Section applies if that is intended.

Where it does apply it is not unusual to qualify the representation so that, in respect accounts or financial statements which may be specified in the Schedule as being required to be delivered (see below), these are only represented to five a fair representation of financial condition or a true and fair view, which is closer to the audit standard.

e. **Payer tax representations**
Each party represents that the tax representations specified in Part 2 of the Schedule as applying to that party are accurate and true.

f. **Payee tax representations**
Each party represents that the tax representations specified in Part 2 of the Schedule as applying to that party are accurate and true.

Section 4 - Agreements

This Section contains a number of undertakings by the parties. These apply so long as ***either*** party has or may have any obligation under the Agreement or under any Credit Support Document. A party which has performed all its obligations is still required to comply with them. The undertakings are as follows:

a. **Furnish specified information**
Delivery of information required under the Schedule or any Confirmation, or which may be reasonably required by the other party in order to enable payments to be made with no withholding or withholding at a reduced rate.

b. **Maintain authorisations**
Maintenance of any applicable governmental or other authorisations.

c. **Comply with laws**
Compliance with all applicable laws and orders, if failure to do so would materially impair a party's ability to perform under the Master Agreement or any applicable Credit Support Document.

d. **Tax agreement**
Notification of any failure of a Payee Tax Representation (i.e. a representation that payments can be made to it without withholdings, because, for example, a double tax treaty applies, or it is a UK recognised bank) to be accurate and true.

e. **Payment of stamp tax**
Payment of any applicable stamp tax.

Section 5 - Events of Default and Termination Events

This Section sets out the Events of Default and Termination Events following which an “Early Termination Date” may be set for the purposes of the Master Agreement.

Slightly different consequences follow from an Event of Default and a Termination Event, though the ultimate effect - early termination and close-out of all affected Transactions - is the same. However, in broad terms an Event of Default is one for which a party is in some way to regarded to be to blame, whereas a Termination Event may simply be suffered by, or happen to, a party.

The specified events are events which occur to a party itself, any “Credit Support Provider” (i.e. an issuer of credit support such as a guarantee) or any “Specified Entity” of that party. A “Specified Entity” is an entity specified for this purpose in the Schedule and would usually be a close group member whose circumstances are likely to impact upon the party itself.

a. Events of Default

These cover:

i. **Failure to Pay or Deliver.** A breach of a payment or delivery obligation. There is a grace period of 3 “Local Business Days” (for these purposes, banking days in the city specified in the address for notice of the defaulting party) from the date that notice of such breach is given. This is reduced to 1 Local Business Day in the 2002 Agreement.

   It should be noted that, unlike the New York Law Credit Support Annex and the English law Credit Support Deed, this Event of Default (and hence the grace periods) applies to transfer of collateral under an English law Credit Support Annex.

ii. **Breach of Agreement**. A breach of any other obligations in the Master Agreement which is not remedied within a 30 day grace period.

iii. **Credit Support Default.** A breach of a Credit Support Document, a Credit Support Document ceases to be in full force and effect before the expiry of the Master Agreement other than as contemplated by its terms, or there is any repudiation or similar action by a party or its Credit Support Provider in respect of a Credit Support Document. There are changes to this event in the 2002 Agreement.

iv. **Misrepresentation.** Any representation, other than one of the tax representations, is incorrect when made or repeated.

v. **Default under Specified Transaction.** This is intended to cover default under other derivative transactions between one party, its Credit Support Provider or Specified Entities and the other party, its Credit Support Provider or Specified Entities.

   The definition of “Specified Transaction” is set out in Section 14 and is very broad, covering most transactions which may be entered into under a Master Agreement. However, it is sometimes amended in the Schedule to broaden or narrow the types of transactions caught.

   In the 2002 Agreement the definition of Specified Transaction has been extended to cover, amongst other things, stock lending and repo transactions but the Event of Default has been amended so that it only applies where there has been an actual acceleration to deal with concerns about liquidity issues which can arise in those markets.

vi. **Cross Default.** This deals with a default by a party, its Credit Support Provider or Specified Entities in respect of “Specified Indebtedness”.
   “Specified Indebtedness” is defined in Section 14 as any obligation in respect of borrowed money. However, this may again be amended in the Schedule. For example, it may be extended to cover derivatives, repos or capitalised payments under leasing obligations. It may also be restricted, by excluding deposits taken by a bank in the ordinary course of its business.
   This Event of Default only applies if it is specified in Part 1 of the Schedule as applying. If it is “switched on” in respect of one party, then the Event of Default will be triggered where there is a default in respect of Specified Indebtedness which exceeds the “Threshold Amount”. The “Threshold Amount” must be specified in the Schedule in respect of each party to which Cross Default applies (see further in Section 3 below).

vii. **Bankruptcy.** This essentially deals with the insolvency of a party, its Credit Support Provider or Specified Entities. It is widely drawn, and covers:

   - dissolution, other than in the course of a consolidation, amalgamation or merger;
   - insolvency or inability to pay debts;
   - compositions, etc, with or for the benefit of creditors;

- insolvency proceedings or proceedings for relief under bankruptcy law, which either result in a judgment of insolvency or bankruptcy, the granting of such relief or the making of a winding-up order, or which are not dismissed or stayed within 30 days of institution. This has been reduced to 15 days under the 2002 Agreement;
- a winding-up or similar resolution, other than pursuant to a consolidation or merger;
- the appointment of an administrator or similar representative;
- enforcement of security or execution of judgments;
- any analogous proceedings; or
- any action to further or consent to any of such proceedings.

viii. **Merger Without Assumption**. This covers a merger or other reorganisation of a party or its Credit Support Provider where the surviving body fails to assume all relevant obligations under the Master Agreement or any applicable Credit Support Document or any Credit Support Document fails fully to extend to the performance by the resulting entity of its obligations under the Master Agreement.

b. Termination Events

For the purposes of these provisions it is important to note which party is to be treated as the "Affected Party", and also which Transactions are to be treated as "Affected Transactions". Which party is the Affected Party differs from event to event and is specified in the Master Agreement. "Affected Transactions" is defined in Section 14 and means, with respect to a Termination Event consisting of an Illegality, Tax Event or Tax Event Upon Merger, all Transactions affected by that event and, with respect to any other Termination Event, all Transactions.

i. **Illegality.** This covers events, other than failure to maintain relevant authorisations, which mean that a party (the "Affected Party") or its Credit Support Provider cannot legally perform its payment or delivery or other material obligations under Transactions or any obligation under a Credit Support Document.

ii. **Tax Events.** This covers any action or proceeding brought by a tax authority, or a Change in Tax Law (defined in Section 14), which has the effect that a party (the "Affected Party") will, or there is a substantial likelihood that it will, be required to make a gross-up in respect of Indemnifiable Tax other than in respect of default interest, or will receive a net payment in circumstances when no gross-up is required and it has not breached its own tax agreements or representations.

iii. **Tax Event on Merger.** This event occurs if there is a merger or similar reorganisation of one of the parties (the "Affected Party") where such reorganisation is not a "Merger Without Assumption" (see above) but results in a deduction on account of tax for which one party is required to gross up payments to the other, or is required to receive payments net in circumstances in which (other than by reason of its own failure to comply with tax covenants or representations) no gross-up is required.

iv. **Credit Event Upon Merger.** This is another event which only applies if specified in the Schedule. If it does apply, then it results in a Termination Event if one party (the "Affected Party") merges with or transfers all or substantially all its assets into another entity and the resulting, surviving or transferee entity is materially less creditworthy than the "Affected Party" immediately before the action.

This Termination Event was changed in the 2002 Agreement and, in both Master Agreements it is not uncommon to seek to define what "materially weaker" means.

Additional Termination Events. This allows additional provisions to be specified in the Schedule if the parties wish to be able to terminate the Master Agreement early for other reasons. It is necessary to specify who the Affected Party is in the Schedule when using this provision.

The difference between the treatment of Events of Default and Termination Events under the Master Agreement and the ISDA Credit Support Documents should be borne in mind when deciding to use this provision, as opposed to including additional Events of Default when dealing with any credit sensitive matters.

i. **Force Majeure**. In the 2002 Agreement an additional Termination Event of Force Majeure applies. This is applies when a force majeure or act of state occurs after the date on which a Transaction is entered into and a party is prevented from performing its obligations under the agreement because of such force majeure or act of state. There is also introduced the concept of a Waiting Period of up to 8 Local Business Days.

Force majeure is not a term of art under English law and consideration should be given to defining this concept in order to reduce the uncertainty as to whether this event has occurred or whether, in fact, an Event of Default has occurred.

c. Hierarchy as between Event of Default and Illegality

Where one event or circumstance constitutes both an "Event of Default" and an "Illegality", it is to be treated as an "Illegality". This may limit the extent to which cross-default provisions under other arrangements may be triggered for reasons which are beyond a party's control. This was also amended in the 2002 Agreement to reflect the inclusion of Force Majeure

Section 6 - Early Termination

a. Right to terminate following Event of Default

The consequences of an Event of Default depend on the Event of Default in question and whether "Automatic Early Termination" has been specified in the Schedule as applying.

The "Automatic Early Termination" provision allows the parties to elect that on certain insolvency events (effectively dissolutions, compositions, winding-up resolutions, the appointment of administrators or similar representatives or other analogous events) the agreement will automatically terminate and the close-out netting provisions will apply. The way in which this option operates is that, where "Automatic Early Termination" has been selected and a relevant event occurs, an "Early Termination Date" is deemed to have occurred immediately before that event.

This provision is desirable in certain jurisdictions where the insolvency regime might otherwise override the close-out netting by providing that on the onset of insolvency different rules override contractual arrangements.

In any other circumstance an Event of Default gives the Non-defaulting Party the right to terminate the agreement and trigger the close-out provisions by designating an Early Termination Date by not more than 20 days' notice to the Defaulting Party.

b. Right to terminate following Termination Event

The consequences of a Termination Event depend on whether one or both of the parties is an "Affected Party".

Any Affected Party must give notice to the other promptly on realising that a Termination Event has occurred. Where there is only one Affected Party in the case of an Illegality or Tax Event, or if there is a Tax Event Upon Merger where the Affected Party is the party required to make a gross-up or to receive a net payment, it must use all reasonable endeavours to transfer its rights and obligations in respect of Affected Transactions to another of its offices or affiliates so that the Termination Event will not occur. It has a period of 20 days from giving notice to the other party of the relevant event. If it is unable to make such a transfer the other party has 30 days within which itself to attempt such a transfer. In either case the prior written consent of the other party is needed for the transfer. In the 2002 Agreement, these provisions are no longer applicable to Illegality, only to Tax Events.

In other cases of any Illegality or Tax Event where there are two Affected Parties, the parties are required to use reasonable efforts to reach agreement on avoiding action within 30 days after notice has been given.

Failing such solutions, or in any other event, an Early Termination Date may be designated by not more than 20 days' notice. Who may designate this depends on the Termination Event in question and in certain instances will be the party to whom the event applies.

c. Effect of designation

Following designation of a Early Termination Date under Section 6(a) or (b):

i. the agreement will terminate on the designated date, whether or not the relevant Event of Default or Termination Event is still continuing; and
ii. the obligation to make further payments or deliveries in respect of "Terminated Transactions" - i.e. all Transactions in the case of an Event of Default, and Affected Transactions in the case of a Termination Event - will end and be replaced by an obligation to pay the close-out amount.

d. Calculations

On or as soon as reasonably practicable following the occurrence of an Early Termination Date (e.g. in the case of Automatic Early Termination, once it has been realised that this has occurred), the close-out amount must be calculated under the close-out netting provisions of Section 6(e). Who makes these calculations will vary from case to case. Broadly speaking, where there is an Event of Default, or a Termination Event with only one "Affected Party", this will be the Non-defaulting Party or the non-Affected Party.

The amount so calculated must be paid (in the case of an Event of Default) on the day that notice to the Defaulting Party of the amount payable is effective or (in the case of a Termination Event) two Local Business Days after such notice is effective, and must be paid together with interest from the Early Termination Date calculated at the "Applicable Rate" (defined in Section 14). The interest basis has changed in the 2002 Agreement.

e. Payments on Early Termination

This is one of the most important provisions in the Master Agreement and sets out the way in which close-out payments are to be calculated.

The object of these provisions is to reduce all the payment and delivery obligations which may be outstanding from both parties under the Master Agreement, whether they require physical delivery of diverse commodities, or payments in different currencies, to a single payment obligation only from one of the parties to the other.

Section 6 achieves this first by providing (under Section 6 (c)(ii)) for the termination of payment and delivery obligations following an Early Termination Date and secondly by substituting for these obligations a requirement to pay the new net amount.

The net amount takes into account the following elements:

i. the value of future obligations owed by each party to the other under outstanding Transactions; and

ii. the value of unpaid amounts which have already accrued and are owed between the parties.

In calculating the net amount the value of future obligations under the 1992 Agreement will be determined by reference to one of two payment measures - either "Market Quotation" or "Loss". The parties should select in the Schedule which of these applies. If no selection is made then Market Quotation will apply.

These terms are both defined in Section 14 of the Agreement. Basically, "Market Quotation" involves the gathering of quotations for replacing the Transactions from leading dealers in the relevant market and "Loss" involves calculating the amount which the calculating party (usually the Non-defaulting Party or party which is not the Affected Party) has lost or gained as a result of the termination.

If "Market Quotation" cannot operate for any reason, for example if too few "Reference Market-makers" provide a quote, or if calculation on this basis would not (in the reasonable belief of the party making the determination) produce a commercially reasonable result, "Loss" will be used as a fallback.

In the case of an Event of Default, the amount actually payable will then depend on the payment method chosen, which will be either the "First Method" or "Second Method".

As mentioned in "Termination and close-out netting" on page 5, the "First Method" is a so-called "walk-away" provision and means that if the close-out calculations show that the net balance is in favour of the Defaulting Party - i.e. that the Non-defaulting Party would otherwise be the one required to make a payment - that payment does not need to be made. This is now very rarely used and there is doubt in a number of jurisdictions whether it is effective. Furthermore, as previously mentioned if included the netting provisions will not be accepted as risk reducing by regulators for capital adequacy purposes.

The "Second Method" provides for full two-way payments on default, and in the situation described, the Non-defaulting Party would be required to make the payment, subject to any other set-off which it may have if the Defaulting Party owes it amounts under other agreements.

On the basis of these definitions/methods, the payment calculations are as follows:

i. **Events of Default**

Market Quotation
The Non-defaulting Party will calculate the sum of: (1) the replacement cost to the Non-defaulting Party of outstanding Transactions (its “Settlement Amount”) and (2) any unpaid amounts owing to it by the Defaulting Party.

If this exceeds the unpaid amounts which it owes to the Defaulting Party, the Defaulting Party will be required to pay it the balance.

If the sum of the amounts above is less than the amount which it owes to the Defaulting Party, on the other hand, then if “First Method” applies no payment will be made to the Defaulting Party and if “Second Method” applies the Non-defaulting Party will be required to pay the balance itself.

Loss
The Non-defaulting Party will calculate the loss that it has suffered as a result of the close-out. If the loss is a positive number (i.e. the Non-defaulting Party has made a net loss) the Defaulting Party will be required to pay this to the Non-defaulting Party. If the loss is a negative number (i.e. the Non-defaulting Party has made a gain as a result of the termination) then where “First Method” applies no payment will be required to be made and where “Second Method” applies, the Non-defaulting Party will be required to pay the net sum to the Defaulting Party.

ii. **Termination Events**
Where early termination follows a Termination Event the consequences differ slightly depending whether there is one or two Affected Parties.

One Affected Party
The non-Affected Party will make the calculations.

- If “Market Quotation” applies, the amount payable will be the difference between (i) the sum of the non-Affected Party’s “Settlement Amount” and unpaid sums owing to it and (ii) unpaid amounts owing by it to the Affected Party.
- If “Loss” applies, the amount payable is the non-Affected Party’s Loss.

Two Affected Parties

- If “Market Quotation” applies, each party determines its “Settlement Amount” and a balance is struck between these and also between the unpaid amounts owing from each party to the other.
- If “Loss” applies a balance is struck between the party with the higher “Loss” and the party with the lower “Loss”.

iii. **Close-out Amounts**

In the 2002 Agreement the terms Loss and Market Quotation are no longer used and the only method of determining values for close out are the provisions of Close-out Amount, This has simplified the close out provisions somewhat.

Where there is an Event of Default, the Non-defaulting Party will determine the Close-out Amount. Where there is one Affected Party, the Non-affected Party will determine the Close-out Amount, subject, however that if the underlying Termination Event is an Illegality or Force Majeure the Close-out amount will be calculated on a mid market basis.

Where there are two Affected Parties, the result is similar to the method in the 1992 Agreement, except that the basis for calculation is exclusively within the definition of Close-out Amount.

Close-out Amount calculations are a more subjective version of Market Quotation under the 1992 Agreement in that they do not require actual bid market quotations. Instead public price source and internal models can be used to get to a commercially reasonable price.

Section 7 - Transfer

Transfers are prohibited without the other party’s consent except:

- in the course of a consolidation, merger, etc, which does not prejudice any other right or remedy of the other party under the Master Agreement; or
- in the case of a transfer of a party’s interest in any amount payable to it by a Defaulting Party under Section 6(e).

Section 8 - Contractual currency

This makes clear that payments must be made in the currencies required under a Confirmation or elsewhere in the Master Agreement and contains currency indemnities if payment is made in other currencies.

Section 9 – Miscellaneous

a. **Entire Agreement.** In the 2002 Agreement, these provisions have been changed and limitation of liability provisions have also been included.

b. **Amendments.** This makes clear that amendments to the Master Agreement can be by electronic messages on an electronic messaging system as well as by other written means.

c. **Counterparts and confirmations.** This makes clear that Transactions are binding on the parties as soon as they are entered into, whether orally or otherwise. It requires a Confirmation to be entered into as soon as practicable after any Transaction is struck and makes clear that this may be delivered by fax, exchange of telex or electronic messages.

d. **Interest and Compensation.** This provision is new to the 2002 Agreement and includes detailed provisions on the various scenarios interest and compensation are potentially relevant under the various payment and delivery obligations under the 2002 Agreement.

Section 10 - Offices, Multibranch parties

a. If this provision is specified in the Schedule as applying, it makes clear that each party that enters into a Transaction through an Office other than its head Office is assuming the same obligations as if the Transaction had been entered into through its head or home Office.

b. This Section clarifies that there may be no change of Office through which payment and deliveries are made or received without the other party's prior written consent. This is an important provision and may result in consent being required for a transfer which would otherwise be permitted without consent under Section 7.

c. If a party is specified in the Schedule as a "Multibranch Party" it can enter into Transactions and make payments and deliveries through any Office listed in the Schedule, provided that the relevant Office is specified in the relevant Confirmation.

- Section 5(a)(v) Default under Specified Transaction
- Section 5(a)(vi) Cross Default
- Section 5(a)(vii) Bankruptcy
- Section 5(b)(iv) Credit Event Upon Merger

Section 11 - Expenses

A Defaulting Party is required to indemnify the other against expenses incurred in enforcing its rights under the Master Agreement or any Credit Support Document.

Section 12 - Notices

This Section sets out the methods by which notices can be served under the Master Agreement (which are personal delivery, mail, telex, facsimile or electronic messaging systems - although the latter two are not permitted for notices relating to Events of Default or Early Termination). It also provides the deemed delivery times for each of these methods. E-mails have been included within the 2002 Agreement for general notices, but are excluded for notices under Section 5 or 6.

Section 13 - Governing law and jurisdiction

a. **Governing law.** The Agreement is designed to operate under either New York or English law. It is important that the relevant law is selected in the Schedule: this is one of the few elections in the Schedule without which the Master Agreement cannot operate. In the 2002 Agreement the submission to jurisdiction in English courts is non exclusive if the proceedings do not involve a Convention Court and exclusive jurisdiction in English courts if the proceedings do involve a Convention Court. A Convention Court includes any court which is bound to apply the proceedings either because of the 1968 Brussels Convention on Jurisdiction or the 1988 Lugano Convention.

   In some instances counterparties may wish to apply other systems of law. This should not be accepted without very careful thought and detailed advice.

b. **Service of process.** A party which is not operating through an Office in the relevant jurisdiction - England or New York - will need to appoint an agent for service of process within the jurisdiction. This is specified in the Schedule.

Section 14 - Definitions

This Section contains most of the definitions used throughout the Master Agreement.

Signatures

There is a space for signatures at the end of the printed terms of the Master Agreement and before the Schedule. The parties may also sign the Schedule. Though this may be desirable to establish that the terms of the Schedule are indeed agreed, it is not essential.

The signature page again reflects the fact that the Master Agreement may be signed after it is intended to take effect. The date to be inserted on the signature page is the date on which the Master Agreement is actually signed. However, as the signature wording makes clear, once signed by both parties the Master Agreement will take effect from the date specified on the first page.

Commentary on the Schedule

References to Sections refer to Sections of the Agreement and references to Parts refer to Parts of the Schedule.

Part 1 - Termination provisions

a. **Specified Entity**
The purpose of this provision is to extend certain of the Events of Default/Termination Events to third parties which a party considers to be relevant to its counterparty's credit standing - for example, other members of the counterparty's group.

The relevant Events of Default/Termination Events are:

It is important to ensure that the entities specified are not drawn from too wide a group. For example, some market participants like to include all their counterparty's "Affiliates". However, Affliates has an extremely wide meaning (see Section 14) and may be too extensive for members of a large group of companies. It is normally preferable, therefore, to include only named entities.

b. **Specified Transaction**
This is given a wide definition by Section 14 of the Master Agreements. However, the definition in the 2002 Agreement extends this even further and some parties have sought to incorporate this extended definition into the 1992 Agreement. If parties do this then it is advisable to amend Section 5(a)(v) (Default Under Specified Transaction) in-line with the 2002 Agreement.

c. **Cross Default**
As noted above, the Cross Default Event of Default only applies if so stated in the Schedule. Where it does apply, the parties should decide:

- What constitutes "**Specified Indebtedness**" for these purposes. As defined in Section 14 this simply represents indebtedness in respect of borrowed money. This is generally felt to be sufficient, particularly in view of the Event of Default in Section 5(a)(v) (Default under Specified Transaction), which essentially covers default under other derivative transactions. Some banks, however, like to extend the definition to include derivatives with third parties and to exclude deposits taken in the ordinary course of business. In the first instance care needs to be taken to define the amount of the Specified Indebtedness.
- The level of the "**Threshold Amount**", being the amount of affected Specified Indebtedness that must be affected by the default before the Event of Default is triggered. Some market participants like to specify this as a proportion of shareholders' equity or net worth, others prefer a specified figure. The latter approach has the advantage of certainty, whereas the former may be useful where two parties with a significant disparity in size want a Threshold Amount that is directly comparable as between them.

d. **Credit Event Upon Merger**
This is a Termination Event entitling a party to terminate all Transactions if its counterparty merges with another body and the resulting entity is materially less creditworthy. Again, it only applies if specifically stated and is usually applied.

e. **Automatic Early Termination**
This is a provision that in certain insolvency circumstances the Master Agreement will terminate automatically on an insolvency event. Normally upon the occurrence of an Event of Default, the Non-defaulting Party must give notice for the Master Agreement to terminate.

Whether Automatic Early Termination should apply will depend in part on the jurisdiction of the counterparty. In certain jurisdictions it is desirable in order to ensure that the close-out netting provisions will work. The opinions that ISDA has obtained on the termination and close-out netting provisions of the ISDA Master Agreement should state whether it is necessary or advisable that Automatic Early Termination should apply to an institution incorporated in that jurisdiction. For example, in the case of a German counterparty AET must be selected, whilst for a Japanese counterparty it is strongly recommended, but for a counterparty from Hong Kong it is recommended AET is not selected.

f. **Payments on Early Termination**
These are dealt with in detail in the commentary on Section 6 in Section 2 above. “Market Quotation” and “Second Method” are usually specified.

This is not relevant in the 2002 Agreement as Market Quotation and Loss are not applicable (only Close-out Amount) and the option to use the First Method is not included in the 2002 Agreement, as the Second Method is embedded.

g. **Termination Currency**
This is the currency in which termination calculations and payments are made. The ISDA form selects US Dollars as a fallback. This is the currency which is most usually selected. Parties also commonly specify a currency in which one or more Transaction is denominated, or may specify the currency of the place of incorporation of one of the counterparties. The latter may have advantages since in a number of jurisdictions claims on insolvency will only be paid in the currency of that jurisdiction.

h. **Additional Termination Event**
This gives the parties an opportunity to add further Termination Events if this is felt to be appropriate in the circumstances. One or two possible provisions are listed in Amendments to the Master Agreement on page 18.

Part 2 - Tax representations

Each party will invariably require that its counterparty gives the standard **payer** tax representation, which is that payments may be made without withholdings.

Whether this can be given may depend on whether the counterparty receives in return a satisfactory **payee** tax representation. In practice, in the case of a UK company, this often used to mean the counterparty giving a representation that it was a UK recognised bank or swaps dealer, or was resident in and operating from a country with an appropriate double tax treaty with the UK and able to benefit from that treaty, or was a financial trader, which would make and receive payments in the course of its business.

However, under legislation introduced in the Finance Act 1994 (known as the financial instruments legislation) it is now clear that a withholding will not arise in the case of **interest rate** and **currency** contracts and options entered into by a company subject to UK corporation tax (other than an authorised unit trust) on or after the start of its first accounting period beginning after 27 March 1995. In respect of these transactions it is clear that the qualifying UK company can generally make payments free of withholding - and can therefore give the standard **payer** tax representation without the need for any **payee** tax representation on the part of its counterparty. It should however be noted that, in order to rely on this legislation, it may still be necessary to seek certain representations from the counterparty in order to establish that certain anti-avoidance provisions do not apply.

As regards payments under transactions outside the scope of the financial instruments legislation, (for example, equity and commodity linked transactions), it is likely that no withholding would arise on these in any event, because they would not be treated as “annual payments” (this being the designation that triggers the obligation to withhold). The predecessor of HM Revenue & Customs in the UK (the Inland Revenue) has confirmed that this would normally be the case.

The tax implications of Transactions under a Master Agreement should, of course, be considered before a course of dealings is entered into because these may differ depending on the particular type of Transaction, or the counterparty.

Part 3 - Agreement to deliver documents

a. **Tax forms, documents or certificates**
Each party is required under Section 4(a)(iii) to provide the other party with any form which may reasonably be needed by the other party in order to enable it to make payments without deduction or withholding.

Where double tax treaty clearance is needed by either party and the forms which will be needed are actually known, these should be specified.

Such documents should be required before the first payment date, and also promptly on reasonable demand by the other party or upon either party learning that any document previously provided has become obsolete or incorrect.

b. **Other documents**
Common requirements are:

i. With a corporate counterparty, constitutional documents (e.g. memorandum and articles of association) may be appropriate, although these are not generally specified between financial traders.

ii. A board resolution authorising the entry into the Master Agreement, and any other corporate authorities that might be appropriate depending on the particular counterparty.

iii. Proof of the authority and specimen signatures of the individuals executing the Master Agreement and any Confirmations are also usually required. These are normally required upon execution and delivery of the Master Agreement and afterwards on request by the counterparty.

iv. For some parties (especially those organised overseas) it may be desirable to require a legal opinion relating to that party's capacity to enter into and perform its obligations under the Master Agreement.

v. Annual reports may also need to be delivered. Where appropriate, they will normally be required to be delivered as soon as they are available or within a specified period of days after the end of each financial year.

If any document to be provided under Part 3 of the Schedule is to be covered by the Section 3(d) representation - namely, that as of the date of such document, the information is true, accurate and complete - this needs to be specified in the Schedule. However, if accounts are to be provided under Part 3 of the Schedule, the Section 3(d) representation is frequently modified - see Part 4 below.

Part 4 - Miscellaneous

This Part of the Schedule is largely self-explanatory and comprises details of the parties.

a. **Process agent**
A process agent will only be required for a party which is not based within the governing jurisdiction (i.e. England and Wales, for an English law agreement, or New York, for a New York law agreement). With a Master Agreement governed by English law, it is possible instead to rely on the provisions of various international conventions (for example, the Brussels Convention) on the service of process overseas although it remains generally preferable for a process agent to be specifically appointed.

b. **Multibranch party**
This allows a party to specify a number of its Offices as eligible to enter into Transactions under the Master Agreement.

Obviously it is important to check the implications of dealing with all the jurisdictions in question. For example, would each of the jurisdictions give effect to the close-out netting provisions, and if not will this affect the overall effectiveness of these provisions? Are there any additional tax implications of dealing with particular jurisdictions? Should Automatic Early Termination be selected for any jurisdiction?

c. **Credit Support Document**
This is a document given in support of a party's obligations under the Master Agreement. Typical examples include guarantees or letters of comfort.

It is very common for market participants to require their counterparties to enter into a collateral agreement, providing for regular marking to market of Transactions and the provision of collateral when exposures cross certain limits. The standard ISDA collateral agreements for this purpose (see above) are increasingly used.

Of the forms of ISDA standard collateral agreement discussed in "Collateral agreements" on page 4, only the English law Credit Support Deed should be specified as a Credit Support Document under the Master Agreement (although the Credit Support Deed contains provisions automatically effecting this). Each of the New York law Credit Support Annex and the English law Credit Support Annex (and, indeed, the Japanese law Credit Support Annex) operate as annexes to the Master Agreement (and, in the case of an English law Credit Support Annex, constitutes a Transaction thereunder). These therefore should not be specified as Credit Support Documents.

d. **Governing law**
English law or New York law should be specified.

e. **Netting of payments**
As discussed in Section 2 on page 7, this is the toggle allowing for payments to be netted across more than one Transaction. If Section 2(c)(ii) is disapplied, then payments falling due on the same date in the same currency between the parties under different Transactions will be netted.

f. **"Affiliate"**
The definition in Section 14 is wide and this is not generally expanded. Sometimes, though, a party may seek to restrict this definition.

Part 5 - Other provisions

This is where it is possible to add extra provisions or make particular amendments to the Master Agreement as agreed between the parties. What is appropriate will depend on the identity of the parties and the types of Transaction in question.

Some provisions which are commonly included in Part 5 of Schedules to Master Agreements are described in the next section.

Amendments to the Master Agreement

General

Amendments or additions to the standard terms of the Master Agreement are normally specified in Part 5 of the Schedule.

Amendments may be based on ISDA wording, on wording which is not published by ISDA but which is widely used in the market or on wording peculiar to particular swap participants. Where appropriate, the standard ISDA wording should generally be used as this increases standardisation in the market and minimises negotiations. Some of the standard wording is set out in the ISDA User's Guide to the 1992 Agreement, and other wording has been published separately by ISDA.

It should be noted that, whilst some amendments to the Master Agreement may be desirable, it can be more difficult and time-consuming negotiating Master Agreements with lengthy and/or complicated Schedules. In addition, any amendments to the termination and close-out provisions should only be made after careful consideration as these could render the relevant provisions of the Master Agreement unenforceable or result in the parties being unable to rely on the legal opinions obtained by ISDA on the enforceability of the close-out netting provisions.

ISDA Amendments

ISDA has developed or suggested wording for amendments and additions to the Master Agreement in appropriate circumstances including the following:

a. **Non-reliance representations**
The purpose of these representations is to ensure that the relationship between the parties is clear. The standard representations describe the relationship most frequently encountered in the wholesale market - i.e. that each party understands and makes it own assessment of each Transaction. The representations should, however, only be included where they accurately reflect the relationship. These were incorporated into the 2002 Agreement as standard elections in Part 4 of the Schedule.

b. **Set-off**
These are provisions enabling a party, after Early Termination, to set-off amounts owing between the parties in respect of other agreements against the close-out payment due under Section 6 of the Master Agreement. The ISDA User's Guide (pages 54-60) contains a number of different set-off provisions and a discussion of these and the 2002 Master Agreement contains a set-off clause as standard. An important point to consider is whether such a provision should apply only as between the parties or whether rights and obligations of affiliated entities should also be taken into account. It should be noted that there can be difficulties with provisions which purport to extend to affiliates which could render this provision unenforceable in some cases. A standard set-off provision is now included in the main body of the 2002 Agreement.

c. **Fully satisfied obligations**
These are provisions limiting a party's rights to withhold payments or deliveries, or to terminate the Master Agreement, where the other has already performed all of its payment or delivery obligations (for example, if one of the parties is a consistent buyer of fully-paid options). Again, these provisions are set out in the ISDA User's Guide (page 7).

The provision which limits the ability of a Non-defaulting Party to designate an Early Termination Date was included as paragraph (4) of the May 1989 Addendum in relation to interest rate caps, collars and floors and as paragraph (5) of the July 1990 Addendum in relation to options. It is necessary to incorporate this additional paragraph in the Master Agreement if the parties intend it to apply.

d. **Impossibility**
This is an Additional Termination Event dealing with "Impossibility" which treats Impossibility as a Termination Event similar in its effects to Illegality. This Termination Event applies to force majeure situations and may be particularly appropriate if commodity derivatives are being entered into. This should not be incorporated into a 2002 Agreement as these events should be covered by the Force Majeure provisions.

e. **Negative interest rates**
These are provisions dealing with negative interest rates. They are now incorporated into the 2000 and 2006 ISDA Definitions so should not need to be included in the Schedule.

f. **BBAIRS/FRABBA bridge**
These are provisions which form a bridge between other market terms and conditions and the Master Agreement so as to bring the relevant transactions under the Master Agreement. The standard wording forms a bridge between the Master Agreement and BBAIRS (British Bankers' Association London Interbank Interest Rate Swaps Recommended Terms and Conditions) and/or FRABBA (British Bankers' Association London Interbank Forward Rate Agreements Recommended Terms and Conditions).

g. **CFTC (Commodity Futures Trading Commission) representations**
These are representations with respect to US Federal commodities and futures laws which may be appropriate where one of the parties could be subject to US regulation. This wording is set out in the ISDA User's Guides to the Master Agreements.

h. **Physical deliveries**
These are supplemental provisions for use where physical deliveries are contemplated. Suggestions for the provisions of the Master Agreement which parties should consider amending are included in the ISDA User's Guide to the 1992 Agreement (pages 61-63), although no actual wording for amendments is given.

i. **Indemnifiable tax**
This is a provision modifying the definition of Indemnifiable Tax in Section 14 of the Master Agreement so that the range of taxes for which the payer may be required to gross up under the Master Agreement is increased very slightly. Again, this wording is set out in the ISDA User's Guide to the 1992 Agreement (page 48).

j. **Jury trial**
This is a provision waiving rights to a jury trial. This wording may be included by or when dealing with a US-incorporated party, a US Office of a party or a New York law Master Agreement. Wording is set out in the ISDA User's Guide to the 1992 Agreement (page 34) - although shorter form wording is often used.

Other common amendments

Apart from the additions and amendments to the Master Agreement based on ISDA wording, certain other amendments are commonly made to Master Agreements. For some of these amendments, the same (or very similar) wording is now used by most market participants. Common amendments include:

a. **Escrow payments**
This is a provision entitling the parties to make payments (or deliveries) in escrow if these fall due on the same day. The purpose of this provision is to provide a mechanism whereby, if payments and/or deliveries on the same day cannot be made simultaneously (for example, because of timing differences in the countries of different currencies), these payments and/or deliveries can be made through a third party. This can reduce or eliminate settlement risk where one of the parties - almost invariably the party paying earlier - is concerned that the other may not perform its corresponding obligations on the same date.

b. **Confirmations**
These are provisions clarifying the role of Confirmations and how these are to be exchanged. These provisions will typically state that the parties are bound to the terms of each Transaction when the essential terms are agreed over the telephone and that written Confirmations will be exchanged subsequently. A provision may also specify which of the parties will produce the written Confirmation and that, if that party does not receive objections to the written Confirmation within a specified period, the other party will be deemed to have approved it.

c. **Tape recording**
This is a provision entitling the parties to (or acknowledging that the parties intend to) record telephone conversations. Consent to the recording of telephone conversations may not be required in the UK in order for such recordings to be admissible in evidence. In some jurisdictions consent is required if recordings of telephone conversations are to be admissible in evidence in court proceedings. There is a standard provision in the Schedule to the 2002 Agreement to cover this.

d. **Credit Event Upon Merger**
The events specified under the Credit Event Upon Merger provision in Section 5(b)(iv) of the Master Agreement will often be extended. For example, the standard wording does not specifically contemplate the situation where a party receives all or substantially all of the assets or obligations of another entity. Other events which are commonly added are changes of control, changes in capital structure and, less often, down-grading of credit rating. The definition of "Credit Event Upon Merger" may also be amended in order to provide greater certainty as to what constitutes "materially less creditworthy".

e. **Automatic Early Termination indemnity**
If "Automatic Early Termination" has been selected, an indemnity may be added in case the markets move between the date of automatic termination and the date on which the Non-defaulting Party becomes aware that the event has occurred.

f. **Capacity representation**
A representation that the parties are acting as principals and not as agent or any other capacity (e.g. fiduciary). This representation might be helpful in some jurisdictions in order to ensure that rights under a contractual set-off provision can be enforced. There is a standard representation in the Schedule to the 2002 Agreement to cover this.

g. **Financial statements representation**
If financial statements are set out in Part 3 of the Schedule as documents to be exchanged and the standard representation in Section 3(d) of the Master Agreement is expressed to apply to them (see "Part 3 - Agreement to deliver documents" on page 17), certain limitations may be applied to the representation. The standard representation in Section 3(d) provides that all information, when provided, is "....true, complete and accurate in every material respect". This may be unduly onerous in the case of financial statements (particularly since this level of accuracy is not required for sign-off by auditors). Therefore the standard wording is commonly modified to the effect that the parties represent that financial statements are "a fair presentation of the financial condition of the relevant party" (or similar wording).

h. **Severability**
This provision stipulates that the rest of the Master Agreement will stand if any of the provisions are held to be illegal.

i. **ISDA Definitions**
A provision incorporating the 2006 ISDA Definitions (and possibly other ISDA Definitions). As noted earlier in this memorandum, it is preferable to incorporate the applicable ISDA Definitions in the Confirmation in relation to each Transaction. This is particularly the case as Definitions are up-dated from time to time and it is not desirable to have to amend the Master Agreement each time the Definitions are up-dated. Care must also be taken to ensure that up-dated Definitions do not apply automatically as this could alter the terms of existing Transactions. However, where only short form or electronic confirmations are exchanged (as is often the case with FX Transactions and Currency Options), it may be appropriate to incorporate the applicable ISDA Definitions in the Schedule to the Master Agreement itself.

j. **Transfer**
This is a provision (usually subject to certain conditions) entitling one or both parties to transfer Transactions to affiliated entities without the consent of the other party.

Annex 1

Transactions documented under the Master Agreements

Basis Swap. A transaction in which one party pays periodic amounts of a given currency based on a floating rate and the other party pays periodic amounts of the same currency based on another floating rate, with both rates reset periodically; all calculations are based on a notional amount of the given currency.

Bond Option. A transaction in which one party grants to the other party (in consideration for a premium payment) the right, but not the obligation, to purchase (in the case of a call) or sell (in the case of a put) a bond of an issuer, such as Kingdom of Sweden or Unilever N.V., at a specified strike price. The bond option can be settled by physical delivery of the bonds in exchange for the strike price or may be cash settled based on the difference between the market price of the bonds on the exercise date and the strike price.

Bullion Option. A transaction in which one party grants to the other party (in consideration for a premium payment) the right, but not the obligation, to purchase (in the case of a call) or sell (in the case of a put) a specified number of Ounces of Bullion at a specified strike price. The option may be settled by physical delivery of Bullion in exchange for the strike price or may be cash settled based on the difference between the market price of Bullion on the exercise date and the strike price.

Bullion Swap. A transaction in which one party pays periodic amounts of a given currency based on a fixed price or a fixed rate and the other party pays periodic amounts of the same currency or a different currency calculated by reference to a Bullion reference price (for example, Gold-COMEX on the New York Commodity Exchange) or another method specified by the parties. Bullion swaps include cap, collar or floor transactions in respect of Bullion.

Bullion Trade. A transaction in which one party agrees to buy from or sell to the other party a specified number of Ounces of Bullion at a specified price for settlement either on a "spot" or two-day basis or on a specified future date. A Bullion Trade may be settled by physical delivery of Bullion in exchange for a specified price or may be cash settled based on the difference between the market price of Bullion on the settlement date and the specified price.

For purposes of Bullion Trades, Bullion Options and Bullion Swaps, "Bullion" means gold, silver, platinum or palladium and "Ounce" means, in the case of gold, a fine troy ounce, and in the case of silver, platinum and palladium, a troy ounce.

Cap Transaction. A transaction in which one party pays a single or periodic fixed amount and the other party pays periodic amounts of the same currency based on the excess, if any, of a specified floating rate (in the case of an interest rate cap), rate or index (in the case of an economic statistic cap) or commodity price (in the case of a commodity cap) in each case that is reset periodically over a specified per annum rate (in the case of an interest rate cap), rate or index (in the case of an economic statistic cap) or commodity price (in the case of a commodity cap).

Collar Transaction. A collar is a combination of a cap and a floor where one party is the floating rate, floating index or floating commodity price payer on the cap and the other party is the floating rate, floating index or floating commodity price payer on the floor.

Commodity Forward. A transaction in which one party agrees to purchase a specified quantity of a commodity at a future date at an agreed price and the other party agrees to pay a price for the same quantity to be set on a specified date in the future. The payment calculation is based on the quantity of the commodity and is settled based, among other things, on the difference between the agreed forward price and the prevailing market price at the time of settlement.

Commodity Option. A transaction in which one party grants to the other party (in consideration for a premium payment) the right, but not the obligation, to purchase (in the case of a call) or sell (in the case of a put) a specified quantity of a commodity at a specified strike price. The option can be settled either by physically delivering the quantity of the commodity in exchange for the strike price or by cash settling the option, in which case the seller of the option would pay to the buyer the difference between the market price of that quantity of the commodity on the exercise date and the strike price.

Commodity Swap. A transaction in which one party pays periodic amounts of a given currency based on a fixed price and the other party pays periodic amounts of the same currency based on the price of a commodity, such as natural gas or gold, or a futures contract on a commodity (e.g. Light Sweet Crude Oil on the New York Mercantile Exchange); all calculations are based on a notional quantity of the commodity.

Credit Protection Transaction. A transaction in which one party pays either a single fixed amount or periodic fixed amounts or floating amounts determined by reference to a specified notional amount, and the other party (the credit protection seller) pays either a fixed amount or an amount determined by reference to the value of one or more loans, debt securities or other financial instruments (each a "Reference Obligation") issued, guaranteed or otherwise entered into by a third party (the "Reference Entity") upon the occurrence of one or more specified credit events with respect to the Reference Entity (for example, bankruptcy or payment default). The amount payable by the credit protection seller is typically determined based upon the market value of one or more debt securities or other debt instruments issued, guaranteed or otherwise entered into by the Reference Entity. Credit protection transactions may also be physically settled by payment of a specified fixed amount by one party against delivery of specified Reference Obligations by the other party. A credit protection transaction may also refer to a "basket" (ten or less) or an "index" (eleven to one hundred twenty-five) of Reference Entities.

Credit Protection Transaction on Asset-Backed Securities. A Credit Protection Transaction for which the Reference Obligation is a cash or synthetic asset-backed security. Such a transaction may, but need not necessarily, include "pay as you go" settlements, meaning that the credit protection seller makes payments relating to interest shortfalls, principal shortfalls and write-downs arising on the Reference Obligation and the credit protection buyer makes additional fixed payments of reimbursements of such shortfalls or write-downs.

Credit Spread Transaction. A transaction involving either a forward or an option where the value of the transaction is calculated based on the credit spread implicit in the price of the underlying instrument.

Cross Currency Rate Swap. A transaction in which one party pays periodic amounts in one currency based on a specified fixed rate (or a floating rate that is reset periodically) and the other party pays periodic amounts in another currency based on a floating rate that is reset periodically. All calculations are determined on predetermined notional amounts of the two currencies; often such swaps will involve initial and or final exchanges of amounts corresponding to the notional amounts.

Currency Option. A transaction in which one party grants to the other party (in consideration for a premium payment) the right, but not the obligation, to purchase (in the case of a call) or sell (in the case of a put) a specified amount of a given currency at a specified strike price.

Currency Swap. A transaction in which one party pays fixed periodic amounts of one currency and the other party pays fixed periodic amounts of another currency. Payments are calculated on a notional amount. Such swaps may involve initial and or final payments that correspond to the notional amount.

Economic Statistic Transaction. A transaction in which one party pays an amount or periodic amounts of a given currency by reference to interest rates or other factors and the other party pays or may pay an amount or periodic amounts of a currency based on a specified rate or index pertaining to statistical data on economic conditions.

Equity Forward. A transaction in which one party agrees to pay an agreed price for a specified quantity of shares of an issuer, a basket of shares of several issuers or an equity index at a future date and the other party agrees to pay a price for the same quantity of shares of an issuer to be set on a specified date in the future. The payment calculation is based on the number of shares and can be physically-settled (where delivery occurs in exchange for payment) or cash-settled (where settlement occurs based on the difference between the agreed forward price and the prevailing market price at the time of settlement).

Equity Index Option. A transaction in which one party grants to the other party (in consideration for a premium payment) the right, but not the obligation, to receive a payment equal to the amount by which an equity index either exceeds (in the case of a call) or is less than (in the case of a put) a specified strike price.

Equity Option. A transaction in which one party grants to the other party (in consideration for a premium payment) the right, but not the obligation, to purchase (in the case of a call) or sell (in the case of a put) shares of an issuer or a basket of shares of several issuers at a specified strike price. The share option may be settled by physical delivery of the shares in exchange for the strike price or may be cash settled based on the difference between the market price of the shares on the exercise date and the strike price.

Equity Swap. A transaction in which one party pays periodic amounts of a given currency based on a fixed price or a fixed rate and the other party pays periodic amounts of the same currency or a different currency based on the performance of a share of an issuer, a basket of shares of several issuers or an equity index, such as the Standard and Poor's 500 Index.

Emissions Allowance Transaction. A transaction in which one party agrees to buy or sell to the other party a specified quantity of emissions allowances at a specified price for settlement either on a "spot" basis or on a specified future date. An Emissions Allowance Transaction may be settled by physical delivery of emissions allowances in exchange for a specified price or may be cash settled based on the difference between the market price of Emissions Allowances on the settlement date and the specified price.

Floor Transaction. A transaction in which one party pays a single or periodic amount and the other party pays periodic amounts of the same currency based on the excess, if any, of a specified per annum rate (in the case of an interest rate floor), rate or index level (in the case of an economic statistic floor) or commodity price (in the case of a commodity floor) over a specified floating rate (in the case of an interest rate floor), rate or index level (in the case of an economic statistic floor) or commodity price (in the case of a commodity floor).

Foreign Exchange Transaction. A transaction providing for the purchase of one currency with another currency providing for settlement either on a "spot" or two-day basis or a specified future date.

Forward Rate Transaction. A transaction in which one party agrees to pay a fixed rate for a defined period and the other party agrees to pay a rate to be set on a specified date in the future. The payment calculation is based on a notional amount and is settled based, among other things, on the difference between the agreed forward rate and the prevailing market rate at the time of settlement.

Freight Transaction. A transaction in which one party pays an amount or periodic amounts of a given currency based on a fixed price and the other party pays an amount or periodic amounts of the same currency based on the price of chartering a ship to transport wet or dry freight from one port to another; all calculations are based either on a notional quantity of freight or, in the case of time charter transactions, on a notional number of days.

Interest Rate Option. A transaction in which one party grants to the other party (in consideration for a premium payment) the right, but not the obligation, to receive a payment equal to the amount by which an interest rate either exceeds (in the case of a call option) or is less than (in the case of a put option) a specified strike rate.

Interest Rate Swap. A transaction in which one party pays periodic amounts of a given currency based on a specified fixed rate and the other party pays periodic amounts of the same currency based on a specified floating rate that is reset periodically, such as the London inter-bank offered rate; all calculations are based on a notional amount of the given currency.

Physical Commodity Transaction. A transaction which provides for the purchase of an amount of a commodity, such as coal, electricity or gas, at a fixed or floating price for actual delivery on one or more dates.

Swap Option. A transaction in which one party grants to the other party the right (in consideration for a premium payment), but not the obligation, to enter into a swap with certain specified terms. In some cases the swap option may be settled with a cash payment equal to the market value of the underlying swap at the time of the exercise.

Total Return Swap. A transaction in which one party pays either a single amount or periodic amounts based on the total return on one or more loans, debt securities or other financial instruments (each a "Reference Obligation") issued, guaranteed or otherwise entered into by a third party (the "Reference Entity"), calculated by reference to interest, dividend and fee payments and any appreciation in the market value of each Reference Obligation, and the other party pays either a single amount or periodic amounts determined by reference to a specified notional amount and any depreciation in the market value of each Reference Obligation.

A total return swap may (but need not) provide for acceleration of its termination date upon the occurrence of one or more specified events with respect to a Reference Entity or a Reference Obligation with a termination payment made by one party to the other calculated by reference to the value of the Reference Obligation.

Weather Index Transaction. A transaction, structured in the form of a swap, cap, collar, floor, option or some combination thereof, between two parties in which the underlying value of the transaction is based on a rate or index pertaining to weather conditions, which may include measurements of heating, cooling, precipitation and wind.

Contacts

Guy Usher
Partner
t: +44 (0)20 7861 4209
e: guy.usher@ffw.com

Edward Miller
Partner
t: +44 (0)20 7861 4205
e: edward.miller@ffw.com

Joe Carrico
Partner
t: +44 (0)20 7861 4212
e: joseph.carrico@ffw.com