



MASTER DERIVATIVES AGREEMENTS

A SOVEREIGN VIEW

**Master derivatives agreements
and other issues in Swap execution**

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- **Enforceability of Close-out netting**
- **Governing Law**



FROM THE TRANSACTIONS TO THE DOCUMENTATION

TRANSACTIONS

- **Interest rate swaps**
- **Currency swaps**
- **FX Options**

PURPOSE

- **Reduce financing costs**
- **Hedge market and budgetary risks**
 - Currency risks**
 - Interest rate risks**



DOCUMENTATION ALTERNATIVES

- **Single product agreement**
- **Master agreement**
 - ☐ **netting**
 - ☐ **reduces negotiation time and expense**
 - ☐ **reduces risk of disagreement over certain terms and provisions**
 - ☐ **facilitates development of secondary market**



ISDA MASTER AGREEMENTS

- **Wide acceptance as the industry standard**
- **Netting**
- **Flexibility**
- **Broad product coverage**



ISDA MASTER AGREEMENTS

1992 ISDA MASTER AGREEMENT (Multicurrency - Cross Border) + SCHEDULE

- **Terms and conditions that apply to Transactions**
- **Incorporates Confirmations**
- **Schedule used to select optional provisions and to amend standard provisions**

CONFIRMATIONS (short-form)

- **Incorporate definitions**
- **Specify economic terms of transaction**
- **(contain transaction-specific modifications)**

ISDA DEFINITIONS

- **1991 definitions (as amended by the 1998 supplement)**
- **1998 FX and currency option definitions**
- **1998 Euro definitions ...**



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PREAMBLE

➤ **« Transactions »**

- Scope**
- Timing**

➤ **« Confirmations »**

- Form**
- Outstanding unconfirmed transactions**



SECTION 2 - OBLIGATIONS

➤ General conditions (2(a))

- Linked transactions**
- Non-standard transactions**

➤ Payment Netting (2(c))

- MA provides for netting of 2 payments made in same currency on same date in respect of same Transaction**
- Parties may elect to net payments in respect of 2 or more Transactions having same payment date and to be made in same currency**



SECTION 2 - OBLIGATIONS

continued

➤ Deduction or withholding for Tax ((2d))

- MA contains broad and complex provisions relating to taxation :**
 - ◆ **section 2 (d), section 3 (e) and (f), section 4 (a), (d) and (e), section 5 (b) (ii) and (iii)**
 - ◆ **schedule : part 2 (tax representations) and part 3 (tax forms)**

- Parties contract on the basis that payments can be made free of withholding;
MA incorporates basic assumptions about allocations of tax risk**



SECTION 3 - REPRESENTATIONS

➤ Basic representations (3(a))

☐ Enumeration of standard representations

- ◆ status, powers, no conflict with laws, existence of necessary consents, obligations binding)**
- ◆ stated to be given as of the date of MA and repeated on each date a Transaction is entered into**

☐ If counterparty = sovereign entity (State, supranational, public body) :

- ◆ Key issue = capacity**
- ◆ Counterparty specific provisions may be required**



SECTION 3 - REPRESENTATIONS ***continued***

- **Accuracy of specified information (3(d))**
 - Schedule allows parties to specify whether the section 3(d) representation will apply to the documents they list**
 - Documents listed : counterparty-specific**



SECTION 5 - EVENTS OF DEFAULT

- **Failure to pay or deliver (5(a) (i))**
 - Grace period = three local business days**
 - May be useful to extend grace period**



SECTION 5 - EVENTS OF DEFAULT ***continued***

- **Credit support default (5(a) (iii))**
 - Form of credit support: third-party guarantee, collateral, comfort letter...**
 - Defaults relating to credit support documentation**
 - Schedule contains details of Credit Support Document(s) and identifies Credit Support Provider**



SECTION 5 - EVENTS OF DEFAULT ***continued***

- **Default under Specified Transaction (5(a)(v))**
 - ❑ **Applies to both parties, any Credit Support Provider(s) and any Specified Entities**
 - ❑ **« Specified Transaction » between (defined in section 14) :**
 - ◆ **each party**
 - ◆ **a party and the other party 's Credit Support Provider or Specified Entity**
 - ◆ **one party 's Credit Support Provider or Specified Entity and the other party 's Credit Support Provider or Specified Entity**
 - ❑ **« Specified Entity » : defined in Schedule**
allows to extend certain Events of Default and Termination Events to entities besides counter party



SECTION 5 - EVENTS OF DEFAULT ***continued***

- **Cross Default (5(a) (vi))**
 - Optional**
 - Can be extended to Specified Entity**
 - Specification of :**
 - ◆ **« Specified Indebtedness » :**
defined in section 14
 - ◆ **« Threshold Amount » :**
to be specified in Schedule



SECTION 5 - EVENTS OF DEFAULT ***continued***

- **Bankruptcy (5 (a) (vii))**
 - Applies to each party, any Credit Support Provider and any Specified Entity (if identified in Schedule)**
 - May be modified in Schedule to cover events that could affect government entities**



SECTION 5 - EVENTS OF DEFAULT ***continued***

- **Merger without Assumption (5 (a) (viii))**
 - Applies to each party and any Credit Support Provider**
 - May be modified in schedule to cover certain events that could affect government entities**



SECTION 5 - EVENTS OF DEFAULT

- **Termination Events (5 (b))**
 - Illegality**
 - Tax event**
 - Tax event upon Merger**
 - (optional) Credit Event upon Merger**
(may apply to Specified Entity)
 - additional Termination event**
(in Schedule or Confirmation)

If counter-party = government entity, may require modification



SECTION 6 - EARLY TERMINATION

- **Procedure in case of Events of Default or Termination Events**
- **Detailed provisions re exercise of right to terminate, effect of termination, calculations, payments**
- **Substantial differences between early termination on basis of Event of Default or Termination Event**



SECTION 6 - EARLY TERMINATION ***continued***



Elections in Schedule

(1) section 6 (a) - right to terminate following Event of Default

- Parties elect whether Automatic Early Termination (AET) will apply to one or both parties**

- Advantages / disadvantages**
 - ◆ **market view**
 - ◆ **legal view**



SECTION 6 - EARLY TERMINATION ***continued***

- **Elections in schedule**
 - (2) section 6 (e) - Payment measure**
 - « Market Quotation » : amount determined on basis of quotations from reference market-makers (for entire portfolio or on transaction basis)**
 - « Loss » : amount determined in good faith by a party to be its total losses and costs (or gains)**



SECTION 6 - EARLY TERMINATION

continued

- **Elections in Schedule**
 - Section 6 (e) - Payment method**
- « First Method » : Limited two-way payments**
Non-defaulting party does not have to pay
if it is « out of the money » on a net basis
- « Second Method » : Full two-way payments**
Non-defaulting party does have to pay
if it is « out of the money » on a net basis



ENFORCEABILITY OF CLOSE-OUT NETTING

- **Relevant jurisdiction**
 - ❑ **Jurisdiction in which counterparty is chartered and, if foreign branch is involved, jurisdiction in which branch is located**
 - ❑ **Jurisdiction whose law governs the individual Transactions**
 - ❑ **Jurisdiction whose law governs the netting agreement (MA)**



ENFORCEABILITY OF CLOSE-OUT NETTING

continued

- **Basic Capital Accord requirements for giving capital relief for close-out netting**
 - Contract providing for single termination payment upon default**
 - No « walk-away » provision (limited two-way payments)**
 - Legal opinions must support enforcement of close-out netting provisions in relevant jurisdiction**



ENFORCEABILITY OF CLOSE-OUT NETTING

continued

- **ISDA obtained various legal opinions covering the enforceability of the termination and close-out netting provisions of the 1992 MA**
- **Careful reading required**



GOVERNING LAW

- **NY or English**
- **Waver of Immunities**