



FEDERATION BANCAIRE DE L'UNION EUROPEENNE
BANKING FEDERATION OF THE EUROPEAN UNION
BANKENVEREINIGUNG DER EUROPÄISCHEN UNION

in co-operation with



EUROPEAN SAVINGS BANKS GROUP
GROUPEMENT EUROPEEN DES CAISSES D'EPARGNE
EUROPÄISCHE SPARKASSENVEREINIGUNG



EUROPEAN ASSOCIATION OF COOPERATIVE BANKS
GROUPEMENT EUROPEEN DES BANQUES COOPERATIVES
EUROPÄISCHE VEREINIGUNG DER GENOSSENSCHAFTSBANKEN

MASTER AGREEMENT FOR FINANCIAL TRANSACTIONS

EXPLANATORY MEMORANDUM

The following is a summary of the aims and structure of the form of Master Agreement for Financial Transactions sponsored by the Banking Federation of the European Union ("EBF" or "FBE") in co-operation with the European Savings Banks Group ("ESBG") and the European Association of Cooperative Banks ("EACB"). The agreement has been drafted following comments from the members of the EBF and the ESBG and others. The text was published on 1 January 2001 on the FBE website, www.fbe.be, on the ESBG website, www.savings-banks.com and on the EACB website, www.gebc.org.

The Agreement is commonly referred to as the European Master Agreement (EMA).

The work on this project has been supported by the law firms Hengeler Mueller Weitzel Wirtz, Frankfurt, and De Pardieu Brocas Maffei & Associés, Paris, acting as advisers for the EBF.

Goals

The European Master Agreement aims to consolidate into a single set of harmonised documents, various master agreements used within the euro zone and certain neighbouring countries, particularly for repurchase transactions and securities lending. At the same time, parties to the EMA are able to choose the applicable law, jurisdiction and contractual language and can take into account various specific national legal requirements. The structure of the agreement is open for new product annexes, in addition to those mentioned under "Structure" below, which can be added in order to expand the scope of the agreement to include other financial transactions, such as FX, swaps and options. The FBE Master is primarily designed to replace master agreements existing under the laws of various continental European countries, which are used predominantly (though not exclusively) in a domestic context. It should also be suitable, however, for cross-border transactions, particularly within Europe.



Benefits

The European Master Agreement will

- enable market participants to document potentially all trading transactions under a single master agreement, including repurchase transactions, securities loans and (possibly at a later stage) other financial transactions, such as FX, swaps and options. To date, a uniform approach to documentation, particularly with respect to repurchase and securities lending transactions, which are closely related in economic terms, has not been undertaken by the market;
- provide a contractual basis for cross-product netting and margining, subject to systems requirements and applicable law;
- result in further harmonisation of operational provisions with the New York or English law master agreements developed by, for example, ISDA, PSA/ISMA and ISLA; this issue is particularly relevant with respect to back-to-back transactions, where inconsistencies can result in mismatches;
- offer a standard for documentation in countries which currently do not have standard forms of their own;
- facilitate trading with an increasing number of counterparties in Europe who request the use of their home country standard, because, if the FBE Master Agreement is broadly accepted, home standards would be nearly identical in many continental European jurisdictions;
- simplify and speed up the documentation process by reducing the number of master agreements which are handled and accordingly the number of legal opinions required; and
- result in cost-savings as a consequence of the foregoing.

Structure

A European Master Agreement will be composed of "Special Provisions", which will constitute an agreement between the parties, and General Provisions, which will always be incorporated into that agreement. Additionally, supplemental "Annexes" may be incorporated at the election of the parties. The initial form of a European Master Agreement will thus consist of the following elements:

1. Special Provisions,
2. General Provisions,
3. Product Annex for Repurchase Transactions,
4. Product Annex for Securities Loans and
5. Margin Maintenance Annex for Repurchase Transactions and Securities Loans.

The Special Provisions will be the only component of the master agreement which is signed by the parties. It will normally constitute the master agreement, incorporate the other components and contain bilaterally agreed provisions, including the choice of law. It may be as short as some two pages if the parties are satisfied with the "regular" provisions of the EMA and do not amend these.

The General Provisions and Annexes are *terms of business* which are not signed as such, but incorporated into an agreement between the parties (normally the Special Provisions). On an exceptional basis, they may be incorporated directly into the terms of a transaction, primarily when a



document based on the form of Special Provisions has not yet been agreed and executed. Section 1(2), second sentence, of the General Provisions deals with such situations.

The General Provisions are a *multi-product* document, comparable to a degree to an ISDA master agreement. They contain contractual principles common to repurchase transactions, securities loans and derivatives. Duplications and inconsistencies as they typically occur when parties enter into different master agreements with each other are thus avoided. A further advantage is that the documents (Annexes) dealing specifically with repurchase transactions, securities loans and margin maintenance are brief and focused technical documents.

General Provisions

The General Provisions contain an introductory clause on purpose, structure, interpretation and possible modifications (Section 1), as well as clauses on operational details such as confirmations as well as payment and delivery procedures (Sections 2 and 3), taxes, particularly withholding taxes (Section 4), representations (Section 5), termination due to defaults and changes of circumstances (Section 6), close out and final settlement (Section 7), notices (Section 8), booking offices (Section 9), other miscellaneous matters, including agency transactions (Section 10) and, finally, governing law and jurisdiction (Section 11).

Generally, these provisions are in line with existing market documentation standards. In cases where these standards are not uniform (e.g. with respect to tax gross-up as well as default and no-default termination events) a choice had to be made or a new approach adopted.

The *withholding tax* and *gross-up* provision, which is relatively brief, differs from corresponding provisions contained in, for example, the ISDA and PSA/ISMA master agreements (where in turn the relevant provisions are different from each other). It is based on the comparatively simple principle that a gross-up should apply in a cross-border, but not in a domestic context. (The ISDA Users Guide published in 1993 contains, on page 48, an *optional* provision which basically follows this approach.)

With regard to *defaults*, Section 6(1) is based on, among others, the following principles:

- Failure to pay (including a failure to pay damages or a cash settlement amount upon non-delivery) is an event of default, but not failure to deliver as such;
- A three Business Day grace period in case of non-payment under a Transaction, but no grace period in the case of a failure to provide margin;
- A cross default provision which contains a materiality limitation (thus protecting against unjustified default terminations in situations where, for example, debts to third parties are not paid by a party due to illegality or impossibility and the counterparty under FBE Master Agreement is not affected);
- Insolvency events relevant only if they happen in a party's home jurisdiction or another jurisdiction specified by the parties. (Insolvency provisions in some market documentation standards, by contrast, seem to suggest that insolvency proceedings in any country, whether or not the party is present there, can trigger a termination right of the other party or an automatic termination.)

Pursuant to Section 11(1) the parties' domestic law will apply for domestic agreements. For cross border agreements, the parties need to make an election. They can choose the domestic law of either party or the law of a third country to be agreed between them.

Product Annexes

The two Product Annexes for repurchase and securities lending transactions, respectively, address the issues arising under both in a consistent manner, to the extent possible. This includes matters such as



late delivery, corporate and other special events, as well as distributions of income and subscription rights; see Sections 2(6), 2(7) and 4 in the Repurchase Annex and Sections 2(5), 2(6) and 3 in the Securities Loans Annex.

Consequential damages in the event of late delivery are excluded in principle, but costs for the borrowing of substitute securities by the party entitled to the delivery may be charged.

Subscription rights will generally be required to be transferred to the seller or lender of the securities, whether or not the buyer or borrower then holds the securities purchased or borrowed, so that the buyer or borrower will often, if not regularly, need to purchase subscription rights in the market in order to then transfer them. The treatment of subscription rights is thus broadly in line with the customary treatment of income distributions under repurchase and securities lending transactions.

With respect to *voting rights*, the Agreement, by not setting forth any special rules in this regard, will have the effect that such rights will be freely exercisable by whichever person that owns the securities at the relevant time. Unless specifically agreed, the seller or lender is not entitled to give voting instructions. The fact that the buyer or borrower may happen to then hold securities of the same kind as those purchased or borrowed will have no impact.

Margin Annex

The Margin Maintenance Annex for Repurchase Transactions and Securities Loans sets out common rules on the provision of margin for both types of transactions. This approach is new in the market. The Annex specifies in Section 1(1) that margining may occur either globally for all such transactions, for each individual transaction or for specified groups of transactions (e.g. by distinguishing between repurchase transactions and securities loans or between equity and debt transactions).

Should the Agreement be later extended to additional types of transactions, the margin annex may be amended or supplemented.

Other Matters

Legal opinions are being sought in the various European jurisdictions, and versions in various languages are being prepared. Information concerning their finalisation will be published on the FBE and the ESBG websites.
