European Financial
Markets Lawyers Group

EFMLG Symposium on Standard Market Documentation

Automatic Early Termination under the ISDA, the GMRA, the GMSLA and the EMA: issues and perspectives

Mario Fiorenzo Bona
London, September 15, 2009

INTESA ⋒⋒ SANPAOLO

Current status: ISDA

- <u>ISDA Master Agreement</u>: (1992):

  - the parties can elect that, following an event of default, the agreement is automatically terminated, without any need for the non defaulting party to deliver a termination notice to the defaulting party: in that case, the transactions under the agreement will cease to be effective on the day when the relevant event of default occurs;

  - if the parties elect not to apply such an automatic early termination mechanism, or simply make no election in that respect, the agreement shall remain effective until the non defaulting party delivers a termination notice to the defaulting one: in that case, the transactions under the agreement will cease to be effective on the day designated (by not more than 20 days notice) as "Early Termination Date" in the relevant termination notice.

Current status (GMRA):

- Global Master Repurchase Agreement (GMRA 2000):

    – the transactions under the agreement are subject to early termination when an event of default occurs AND the non defaulting party serves a default notice to the defaulting party;

    – further, the transactions under the agreement are subject to early termination when a tax event occurs AND the affected party serves a notice in respect therewith to the other party;

    – by way of exception to the above, the transactions under the agreement are automatically terminated in the case of an act of insolvency which is the presentation of a petition for winding-up or any analogous proceeding or the appointment of a liquidator of the defaulting party / an officer with the same functions: in this scenario, in fact, no notice is required.

Current status (GMSLA):

- Global Master Securities' Lending Agreement (GMSLA 2000):

  – the transactions under the agreement are subject to early termination when an event of default occurs AND the non defaulting party serves a written notice to the defaulting party;

  – by way of exception to the above, the transactions under the agreement are automatically terminated in the case of an act of insolvency which is the presentation of a petition for winding-up or any analogous proceeding or the appointment of a liquidator of the defaulting party / an officer with the same functions: in this scenario, in fact, no notice is required.

Current status (GMSLA):

- Global Master Securities' Lending Agreement (GMSLA 2009):

    - the transactions under the agreement are subject to early termination when an event of default occurs AND the non defaulting party serves a written notice to the defaulting party;

    - by way of exception to the above, the transactions under the agreement are automatically terminated in the case of an act of insolvency which is the presentation of a petition for winding-up or any analogous proceeding or the appointment of a liquidator of the defaulting party / an officer with the same functions: in this scenario, in fact, no notice is required, PROVIDED THAT the schedule of the agreement elects to apply the "Automatic Early Termination"

. <u>EMA – Master Agreement For Financial Transactions – General Provisions</u>

(Edition 2004):

Section 6 (1), b: Termination

- all outstanding Transactions under the agreement, will terminate when an event of default occurs AND the Non Defaulting Party serves a written notice to the Defaulting Party.

<u>Quote</u>

- *"If an event of default occurs with respect to a party ("the Defaulting Party") and is continuing, the other party (the "Non Defaulting Party") may, by no more than twenty days' notice specifying the relevant Event of Default, terminate all outstanding Transactions, but not part thereof only, with effect as from a date (the"Termination Date") to be designated by it in such notice."*

Current status: EMA

 An exception to the foregoing is provided for under sub-paragraph of Section 6 (1), b;

- pursuant to such sub-paragraph, upon the occurrence of an insolvency event (which is a dissolution or an act of insolvency, that is a presentation of a petition for bankruptcy or any analogous proceeding or the appointment of any competent officer or authority of the defaulting party), all Transactions shall terminate automatically. In this case, no notice will be required.

Quote
"Notwithstanding the foregoing, unless specified in the Special Provisions, all Transactions shall terminate, and the Termination Date shall occur, automatically in the case of an Event of Default mentioned in paragraph (a)(viii) (Insolvency Events) (1),(2),(3),(5)A or, to the extent analogous thereto, (9) as of the time immediately preceding the relevant event or action."

The parties may disapply sub-paragraph of Section 6 (1), b, under the Master Agreement for financial transactions, Special Provisions.

Questions: what should be the principle?

- to some extent, the GMRA, the GMSLA and the EMA envisage the principle that the early termination of the transactions is subject to the delivery of a specific termination notice, unless such a termination depends on certain situations of insolvency: in this case, there is no need for a termination notice (i.e., the early termination is automatic);

- the ISDA Master Agreement envisages instead the principle that the early termination of the transactions is never automatic unless the parties have specifically agreed that automatic early termination shall apply;

- where the relevant event of default depends on insolvency, the principle envisaged by the GMRA, the GMSLA and the EMA seems to be safer, since it does not leave room for any "walk away" course of conduct, which may favour certain debtors of the DP to the damage of its creditors; in order to prevent the above discussed asimmetry in the absence of an AET principle, counterparties may want to consider to include in the ISDA Schedule an Additional Termination Event entitling the DP to designate an ETD should the NDP refuse to exercise its right to terminate the agreement.

Questions: what should be the principle?

- further, AET is recommended in various legal opinions in order to close-out prior to the otherwise applicable insolvency regime, which would voiden the netting.

- on the other hand, an advantage of having AET not applicable is that the non-defaulting party can select an ETD in the near future with respect to which the replacement costs and losses can be calculated.

- the problem with AET is that the non-defaulting party may learn about the termination at a very late point in time and would have to calculate the close-out amount using rates and prices that are no longer prevailing in the market when replacing hedges or unwinding trades.

Questions: what should be the principle?

Based on the foregoing, the principle about automatic early termination could be designed as follows:

- the automatic early termination should be elected under the ISDA Master Agreement, the GMRA, the GMSLA and the EMA where the relevant event of default depends on certain situations of insolvency (which should be worded in the same manner, and with the same terminology, in all said agreements);

- where the event of default does not depend on (and is independent from) insolvency situations (e.g., failure to pay or to deliver relating to a single transaction), it seems fair that parties can freely decide whether to terminate or not their agreement(s); in fact, this kind of event of default mainly regards the bilateral relationship between the parties, while, on the contrary, an event of default linked to insolvency is likely to have a systemic fall-out.

- As mentioned above, the events of default that trigger the AET should be those linked to certain situations of insolvency;

- in view of that, it is critical that such events (i) are worded in the same manner in the ISDA Master Agreement, the GMRA, the GMSLA and the EMA, and that, (ii) through the legal opinions issued by ISDA, ICMA, ISLA and FBE for EMA (the latter being a multi-jurisdiction agreement) in respect therewith, it can be easily and safely checked whether a certain local situation of insolvency triggers (or does not trigger) the relevant provision of the agreement;

- since this check could be sometimens particularly difficult (e.g., if an administrator is appointed by a Bankrupcty Court, or by a Public Autorithy, to cure mismanagement rather than financial distress: is that an event which triggers the AET ?), the introduction of a short assessment period /formalized procedure might be usefully considered in order to give to all concerned parties sufficient evidence and information about the nature of the event, so putting each of them on the same footing.

Questions: is there any need for further harmonisations?

- **ISDA, ICMA, ISLA and FBE might issue guidelines / introduce clauses, all with the same wording, dedicated to the specific jurisdictions, to be implemented in the ISDA, GMRA, GMSLA and EMA Master Agreements with the purpose to reduce to a mininum the potential discrepancies between local rules of insolvency laws and the AET provisions contained in the MA whenever they conflict, or may conflict, in whole or in part, with such laws; the parties would then adjust their MA accordingly.**