



EUROPEAN CENTRAL BANK

DIRECTORATE GENERAL - LEGAL SERVICES

To the Members of the
European Financial Market Lawyers Group

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European Master Agreement (EMA) – Issues paper

In January 2001 the Banking Federation of the European Union (FBE), in co-operation with the European Savings Banks Group and the European Association of Co-operative Banks, announced that the Master Agreement for Financial Transactions, commonly known as the European Master Agreement (EMA), is now fully ready for use by the European banking industry as legal opinions for a significant number of jurisdictions have been finalised. Final legal opinions for the following jurisdictions are now available: Belgium, Germany, Spain, France, Ireland, Luxembourg, the Netherlands, Austria, Finland, Switzerland and England & Wales. A draft final opinion for Portugal is also available, and a draft opinion for Italy is in the process of being finalised.

In January 2001, the EMA's sponsors also released the final January 2001 edition of the EMA, a copy of which is published on the FBE website. The EMA aims to consolidate into a single set of harmonised documents various master agreements used for both domestic and cross-border transactions in the euro area and European financial markets. Indeed, the introduction of the euro provided a catalyst for the development of the EMA as it was felt that the introduction of the single currency warranted a reconsideration of the concept of domestic money markets and that the continuing existence of divergent national domestic master agreements might not be appropriate in view of the emergence of a single money market in the euro area, particularly for euro-denominated repo and securities lending markets.

In order to accommodate its usage between parties located in both the same and different jurisdictions, the EMA has a strong multi-jurisdictional character. The EMA leaves it entirely to the parties to agree on both the governing law and the courts having jurisdiction over any proceedings between the parties. Linked to its multi-jurisdictional nature, another unique feature of the EMA is its multi-lingual character. While the original text of the EMA was drafted and published by its sponsors in the English language, versions in other European national languages, including German, Spanish, French, Italian and Portuguese, have been agreed by the relevant national banking associations.

As published, the EMA currently constitutes a master agreement for repurchase and securities lending transactions. Currently, repurchase and securities lending transactions between parties incorporated or located in the euro area are documented under a wide variety of master agreements. In Germany the *Rahmenvertrag für echte Pensionsgeschäfte* and the *Rahmenvertrag für Wertpapierleihgeschäfte*, both governed by German law, subject to the jurisdiction of German courts and drawn up in the German language, are used to document repurchase transactions and securities loans. While these agreements are mainly used within the German domestic market, they are also used on a cross-border basis, mainly (but not exclusively) in German speaking countries. In France the *Convention-cadre relative aux opérations de pension livrée* and the *Contrat Cadre de Prêts de Titres*, governed by French law, subject to the jurisdiction of French courts and drawn up in the French language, are used to document repurchase transactions and securities loans, again mainly but not exclusively within the French domestic market. In Germany and France the *Global Master Repurchase Agreement* (GMRA), governed by English law, subject to the jurisdiction of English courts and drawn up in the English language, and the *Master Repurchase Agreement* (MRA), governed by New York law, are also used for cross-border transactions, particularly with counterparties outside the euro area but also on a cross-border basis within the euro area. In the Benelux countries and in Ireland the *Global Master Repurchase Agreement* is widely used to document both domestic and cross-border repurchase transactions, although for domestic transactions in Belgium and the Netherlands parties use domestic annexes whose provisions are subject to the laws of Belgium and the Netherlands, respectively. In Austria, both the *Global Master Repurchase Agreement* and the *Rahmenvertrag* documentation are in use. In Greece, Spain, Italy and Portugal parties have, for various reasons, been traditionally reluctant to execute master repurchase and securities lending agreements. To the extent that master agreements are in use, the *Global Master Repurchase Agreement* and the *Master Repurchase Agreement* are used to a limited extent for cross-border transactions, while for domestic transactions a variety of master agreements are used in Italy. In the domestic Greek, Spanish and Portuguese markets, domestic agreements are not used in practice. In Finland, there is no domestic repo or securities lending market, and to the extent that parties have documented cross-border transactions, the *Global Master Repurchase Agreement* is in use. Finally, for cross-border securities lending transactions the stock

lending agreements such as the *Overseas Securities Lender's Agreement* (OSLA) governed by English law and sponsored by the International Stock Lenders Association (ISLA), is also used to a certain extent by market participants within the euro area.

Based on the above, it is clear that the master agreements used for the documentation of repurchase and securities lending transactions in the new euro-denominated market within the euro area are highly fragmented.

EFMLG members are invited to exchange views as to whether the EMA provides an appropriate platform for the harmonisation of repurchase and securities lending master agreements in the new euro-denominated market within the euro area, particularly having regard to the multi-jurisdictional and multi-lingual characteristics of the EMA.

Legal opinions supporting the use of the EMA under the laws of jurisdictions outside the euro area – Switzerland and England & Wales – are also available. In Switzerland the *Global Master Repurchase Agreement* is used in cross-border transactions, while in the domestic market a *Schweizer Rahmenvertrag für Repo-Geschäfte* governed by Swiss law is in use. In the United Kingdom the *Global Master Repurchase Agreement* appears to be exclusively used for both domestic and cross-border transactions, while a number of securities lending agreements governed by English law, primarily the *Overseas Securities Lender's Agreement*, are used. In addition, legal opinions may also be expected for Denmark and Sweden.

EFMLG members are invited to exchange views as to whether the EMA provides an appropriate alternative master agreement for the documentation of repurchase and securities lending transactions between parties in the euro area and parties in other European jurisdictions, such as Switzerland and the United Kingdom, having regard to the multi-jurisdictional character of the EMA.

The EMA's sponsors have announced that they are in the process of developing further the EMA as a multi-product agreement that will enable market participants to document under a single master agreement a variety of financial trading transactions, including derivatives and foreign exchange transactions. A draft annex for derivative transactions has been under discussion by the EMA drafting group for some time, and provisions for the collateralisation of exposures arising out of derivative transactions may also be developed. It is understood that the EMA's drafters foresee that 'plain vanilla' currency and interest rate swaps could be conducted by the exclusive use of the EMA (including the derivatives annex). Market participants wishing to document more complex derivative products might, however, need to develop a 'bridge' construction with other market standard

documentation, perhaps by incorporating the ISDA definitions into the terms of any derivative transactions documented under EMA, with the parties still using the EMA as the underlying master agreement for close-out netting and other general purposes.

EFMLG members are invited to exchange views regarding the possible development of the EMA as a multi-product agreement for the documentation of financial trading transactions other than repurchase transactions and securities loans.

The EMA's General Provisions (including clauses on purpose, structure and interpretation, operational details such as confirmations, payments and delivery procedures (including payment and delivery netting), taxes, representations, termination, close-out and calculation/payment of final settlement amounts, notices, booking offices, and miscellaneous matters) are broadly in line with comparable provisions contained in other master repurchase agreements and master swap agreements used in cross-border financial markets. In a number of places the drafting closely follows either the GMRA and/or the International Swaps and Derivatives Association (ISDA) Master Agreement, or seeks to strike a balance between these two master agreements.

The events of default under the EMA differ from those applicable under the GMRA (2000 version) in several respects.

- Unlike the GMRA, a 3-business day grace period is available under the EMA in the event of a payment failure/ default by a counterparty.
- Settlement failures can, at the parties' option, constitute grounds for triggering an event of default under the new GMRA, whereas this is not possible under the EMA.
- The EMA, reflecting its multi-product nature under which both repos and derivatives may be documented, contains a number of credit-related defaults that can also be found in the ISDA, but which have never been considered necessary under the GMRA in view of the self-collateralising character of repo transactions. Thus, the EMA allows parties to specify cross-default and 'default under specified transactions' clauses. Similar to the ISDA (and unlike the GMRA), the EMA contains a 'corporate restructuring without assumption' event of default, and allows for termination following a 'credit event upon corporate restructuring'. Like the ISDA, the EMA applies the events of default to a party's guarantor. The EMA's emphasis (in contrast to the GMRA) on the inclusion of credit-related default provisions would appear more consistent with best practices emerging in global financial markets, and it is noted that the Global Documentation Steering Committee (formed to continue the discussion begun by the globally-oriented Counterparty Risk Management Policy Group (CRMPG) established in 1998 to enhance counterparty credit and market risk management after the market disruptions of 1997 and 1998) has made a recommendation urging The Bond Market Association (TBMA) to rapidly implement

a cross-default provision in the various master agreements sponsored by TBMA, including the GMRA.

- In contrast to the expansion of the credit-related events of default in the EMA as compared to the GMRA, the EMA contains a narrower definition of insolvency-related events of defaults than the GMRA. Thus, the EMA, unlike any other master agreements (including both the GMRA and the ISDA), contains a territorial limitation on the scope of insolvency-related events of default, such that the EMA insolvency-related events may only be triggered if they occur in a party's home jurisdiction or in other jurisdictions specified by the parties. The rationale behind this limitation is that the EMA's drafters were keen to ensure that a close-out could not be triggered by insolvency proceedings in any country, regardless of whether the party is present or has significant assets there. Another unique feature of the EMA is that, unlike the GMRA, obviously inadmissible or frivolous insolvency proceedings commenced by a person other than a competent authority will not trigger a close-out event of default.
- In the EMA, an action by a 'competent authority' under any bankruptcy, insolvency or similar law or any banking, insurance or similar law governing the operation of the party which is likely to prevent the party from performing when due its payment or delivery obligations under the EMA, does not constitute an automatic event of default, whereas the occurrence of any 'act of insolvency', including similar actions taken by supervisory authorities, triggers an automatic close-out under the GMRA.
- Like the ISDA, the EMA allows for termination due to illegality.
- The EMA also contains an optional impossibility clause, and in this regard it is noted that ISDA is currently developing a standardised force majeure provision.

Similar to the ISDA, the EMA allows for a greater measure of recovery following close-out than the GMRA, permitting recovery of either losses incurred or gains realised as a result of the termination of transactions or (at the calculation party's option) the cost of (based on arithmetic mean of quotations for) replacement or hedge transactions. Thus the EMA close-out mechanism is generic in order to have the broadest possible application in view of the EMA's multi-product nature. By contrast, under the GMRA (2000 version) neither party may claim consequential losses, except losses incurred in entering into replacement transactions or in unwinding hedging transactions (less the amount of any gain/profit made in connection with such replacement or unwinding transactions).

Regarding asset valuations following close-out, there is less scope under the EMA than the GMRA (2000 version) for a non-defaulting party to choose to calculate default market values by reference to sources other than available market sources.

One particular cost recoverable under the EMA, but not under the GMRA, is the excess borrowing cost resulting from delivery failures (e.g., the cost which the non-defaulting party incurred or would have reasonably incurred in borrowing equivalent securities in the market for the relevant period). It is understood that the ability to recover excess borrowing costs in the event of delivery failures under the EMA has been received negatively by the ACI/ISMA European Repo Council (ERC), and that this may be an important distinction between the EMA and the GMRA in practice due to the high volume of settlement failures in repo markets.

Regarding the mechanics of conducting repo transactions, the EMA contains broadly comparable provisions to the GMRA relating to margin calls, repricing, substitutions, manufactured dividends for coupon-paying securities and the conduct of buy/sell back transactions.

A more comprehensive comparison between the EMA and the GMRA (2000 version) is attached to this issues paper.

EFMLG members are invited to exchange views regarding the EMA, including from a technical drafting perspective.