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European Financial Markets Lawyers Group

Execution Formalities in respect of Master Agreements

Issues note following the EFMLG meeting on 3rd June, 2003

Introduction

1. For the purposes of discussion I will outline my views and experiences with regard to the execution authorisations furnished by financial institutions in relation to the execution of Master Agreements and other ancillary documents, such as, a guarantee ("Master Agreements"). I do not deal with the quite separate issue of a financial institution's capacity to enter into a Master Agreement.

2. In my experience the variation in execution authorisation formats is legion. It is fair to say that every financial institution has its own individual format, a substantial number of which are problematic from an interpretative point of view; in consequence further, and often tortuous and time-consuming enquiry, is required. Two possible explanations come to mind for this quite unnecessary situation. It may simply be a case of poor draftsmanship. On the other hand, it may be an attempt by the financial institution to limit its risk by externalising its internal controls thus imposing an unacceptable burden on the counterparty.

3. Subject to paragraph 4 below, execution authorisations accompanying ISDA Master Agreements ("ISDA") or Global Master Repurchase Agreements ("GMRA") generally speaking, comprise two inter-related components:

(A) The Identification of the type of Transaction.

together with

(B) The Identification of the person or persons authorised to sign the Master Agreement.

As to (A) – the identification is formulated in a number of ways including the following:-

(a) **Identification of the relevant Master Agreement or Agreements** without further elaboration or restriction (ISDA or GMRA).

This approach appears to be the least problematic and one which might be given favourable consideration.

(b) **Identification of the relevant Master Agreement but limited to certain specified transactions/product types.**

This approach reduces the scope of transactions which may be carried out under an ISDA. The following examples illustrate this problem. The example at (iii) is dangerously limiting.

(i) "any master agreement or agreement, transaction or confirmation or similar supplement to a master agreement relating to any type of foreign exchange transaction, including but not restricted to option agreements, or any rate protection transaction(s), however described, or any combination thereof."

(ii) "Any master agreement concerning the exchange of notional principal amounts or interests (interest rate SWAP, cross currency rate SWAP), as well as any master agreement, either specific or linked to other dispositions, concerning interest rate operations (FRA, floor, cap, collar...) and/or concerning options on currencies or on swaps…, any combination of swaps, operations on interest rate and/or on currencies as well as any confirmation of operations of this kind; any agreement relating to a purchase or a sale (cash or term), to a borrowing or a lending of foreign currencies, as well as any confirmation of an operation of this kind".

(iii) "hereby appoints each of the persons named on the attached Exhibit A acting alone to sign ISDA Master Agreements relating to all fixed income products".

(c) **Identification of Transaction by way of enumeration**

(i) This approach may also limit or otherwise confuse the scope of the Master Agreement. Such clauses may take the following form:

"The entering into of Derivatives or similar Contracts"

The disadvantage of this approach is the need to determine what are similar contracts. This was well illustrated in a particular case where the proposed transaction was a

repo to be covered by a GMRA – the better opinion is that a repo is not a "Derivative or similar Contract". On enquiry an alternative appropriate authorisation was furnished.

(ii) "Any other similar transactions"

The obvious problem which will arise in this case is that the proposed transaction is not included within the enumerated transactions; in consequence the counterparty is required to make a judgment as to whether the proposed transaction is sufficiently 'similar' to those specifically enumerated.

(d) **Identification of Transaction by reference to Purpose**

Occasionally, execution authorisations may be limited, quite inappropriately in my view, by a statement to the effect that the purpose of the transaction is for:-

"hedging"

or

"in connection with the business of a particular division of the Institution".

The outcome of such restrictions is to necessitate further enquiry by the counterparty. If the restriction is not easily and objectively verifiable the prudent counterparty will have a dilemma.

(e) **Identification of Transactions in an ambiguous manner**

An example of this approach is that of a very detailed laundry list of treasury transactions purporting to authorise the execution of an accompanying ISDA – not only is there no reference to the Master Agreement but even more unsatisfactory is the fact that the transaction descriptions are only to be effected in connection with commodities trading. In consequence, if the counterparty were to enter into a rate swap transaction with the financial institution the prudent counterparty would have to obtain representations from the financial institution that the particular rate swap transaction is a "Commodities

Transaction" and is permissible under the Resolution referred to below. The particular text is as follows:-

e.g. "RESOLVED, that each of the President, any Director and any Senior Vice President (each an "Authorised Officer") is authorised to effect spot, forward and derivative transactions *in commodities*[1] and foreign exchange and contracts relative thereto including, without limitation, any transactions which is (a) a rate swap transaction, basis swap, forward rate transaction, commodity swap, commodity option, equity or equity index swap, equity or equity index option, bond option, interest rate option, foreign exchange transaction, cap transaction, floor transaction, collar transaction, currency swap transaction, cross-currency rate swap transaction, currency option or any other similar transaction (including any option with respect to any of these transactions), (b) any combination of these transactions (all such transactions referred to herein as "Commodities Transactions") in the name of the Corporation and to delegate that authority to one or more employees of the Corporation ("Authorised Traders") and to give written notice from time to time of the names of such Authorised Traders to institutions with which the Corporation effects Commodities Transactions."

"FURTHER RESOLVED, that each Authorised Officer is authorised to execute, acknowledge, consent, accept, deliver and/or file, in the name of the Corporation, any and all agreements, documents, instruments and confirmations (whether in written, oral or computerised form) relating to Commodities Transactions authorised by the preceding resolution and to delegate that authority to one or more employees of the Corporation ("Authorised Persons")."

(ii) "Any agreement arising in the ordinary course of this Institution's business in its Treasury and Structured Finance Divisions".

The problem of interpretation here is self-evident.

<u>As to B</u>

This component of an execution authorisation is not usually as troublesome as the identification of the 'Transactions" – however, it is not free of difficulty – in this regard I highlight a number of typical examples.

(a) **<u>Ambiguous alternative signatories provisions</u>**

[1] emphasis added

A bizarre illustration of this method was a provision which provided for the document to be signed "by the Treasurer and in the absence or disability of the Treasurer by the Assistant Treasurer". In the event the document was signed by the Assistant Treasurer and we were put on enquiry – unnecessarily.

(b) **Signatories described by reference to their functions rather than by name**

"The document may be signed by a Financial Markets Lawyer, a Divisional Secretary, a Chief Operating Officer".

This kind of provision properly requires further enquiry as to whether the individual signing as, for example, a person signing as Chief Operating Officer held such office at the time of signing or at all.

(c) **Reference to the signatory book**

In theory a signatory book per se is workable. However, the signatory book can carry certain disadvantages.

(i) The signatory book may simply provide for persons who can sign "on behalf of Head Office" – not sufficiently specific.

(ii) Absence of any confirmation (even a letter) to the effect that the particular signatory book has not been superseded.

(iii) On occasions the signatory book is in a language other than that of the counterparty to which it is addressed.

(d) **Reference to a Commercial Register**

A problem in this context arose where the execution authorisation omitted the name of a person who was, according to the particulars filed by the financial institution with the Commercial Register, and named in the Monitor Belge, an essential signatory to the particular contract. The Agreement had to be re-executed.

This issue might be discussed, in particular, whether or not, in any country, the signatures authorised on the Commercial Register may not be superseded by subsequent authorisations.

4. **Execution Authorisation having no reference to a Master Agreement or particular transaction**

These execution authorisations make no reference to the transactions involved but contain only a signature list attached in the accompanying Master Agreement to be signed – this may take the form of a signature book or signature list e.g.

> "Our Company is legally bound by the joint signatures of two persons authorised to sign, one of which must belong to Class 'A'. Exceptions to joint signature requirements may apply to correspondence consisting of certain form letters; such exceptions are mentioned on said form letters."

This approach appears to be a reasonable compromise provided it is an all embracing authority covering the complete spectrum of the counterparty's business and is not limited in any way.

An example of a case which did not refer to any Master Agreements or transaction but which was unsatisfactory is as follows:-

> "Unless from time to time otherwise adopted, amended or extended by the Directors, the signatory requirements of X Bank are that all documents must be signed by two A signatories or one A signatory and one B signatory.
>
> Any signatory authority granted on behalf of X Bank shall automatically be withdrawn and cease upon termination of employment with X Bank."

Further enquiries had to be made to ensure that the signature list (which was out of date when received) was not amended and that the signatories were employed by the bank as at the date of signing.

5. **Source of the Execution Authorisations**

An additional ingredient affecting the execution authorisations is that of the source of the execution authorisation.

(a) In common law countries the execution authorisation will usually take the form of:-

(i) a certified extract from the Minutes of a Meeting of the Board of Directors of the financial institution; or

(ii) by way of a Power of Attorney given by the financial institution under its common seal; or

(iii) frequently an excerpt from a signatory book.

(b) In civil law countries the execution authorisation will usually take the form of a

(i) Power of Attorney; or

(ii) An extract from the signatory book of the financial institution.

6. **Confirmation of continued existence of the Execution Authorisation**.

Ideally all of these forms of execution authorisation require to be accompanied by a contemporaneous confirmation given by a recognised Officer of the financial institution that it is still in full force and effect.

Furthermore, where a Power of Attorney is involved the source of this Power, if given by individuals, rather than by the financial institution, may be required.

An example of an enquiry which we were required to make arose in the case of a civil law jurisdiction where a Power of Attorney was granted by two individuals – the Power of Attorney was satisfactory as to content but it was unclear as to how the grantors had derived their authority to give this Power. We failed to elicit the necessary information from the financial institution and had to instruct a local lawyer to investigate this matter which he did via the Commercial Register: in the

event the grantors had the requisite power. Apparently, the grantors were Prokurists in the Commercial Register.

7. **Conclusion**

The foregoing survey illustrates some of the problems in execution formalities in relation to Master Agreements which have been encountered with financial institutions in sophisticated jurisdictions. It is fair to consider, if this is the form of documentation they provide, what form they require. Failure for a given transaction to fall within the defective authority raises the spectre of unenforceability and uncertainty. Arguments may exist that these financial institutions would, for reputational reasons, not seek to evade their responsibilities through technical quibbles or that they remain bound on principles of apparent authority or estoppel. These are arguments one might wish to make after the fact; they are not prudently reliable before the fact. It is clear that there is a need for some attention to be paid to such formalities to reduce time consuming enquiries and introduce greater certainty into the financial markets.

It is understandable that financial institutions may wish to impose restrictions on their signatories; indeed, it is prudent for them to do so. On the other hand, financial institutions cannot expect the counterparty at one and the same time to be its arms-length trading party and to bear the risk of its own internal failures or controls. Clearly, some form of balance has to be achieved between protection of the parties involved and the ability to trade in a flexible, transparent and safe manner.

Several approaches suggest themselves. One would be a legal/regulatory approach which would, with respect to regulated financial institutions, clarify that any action in excess of a signatory's authority would not provide it with a defence to enforcement. Another approach would be to develop a "best practices" statement for financial institutions in each member country or on an EU-wide basis. Perhaps a combination would be advisable.

These are just several of the avenues which might be explored by the Sub-group to be established and which will commence its deliberations in the near future.

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