EMU Annex with guidance notes

PSA/ISMA Global Master Repurchase Agreement

Additional terms and conditions relating to European Economic and Monetary Union

1. Interpretation

In this Annex -

"*euro*" means the currency of the member states of the European Union that adopt a single currency in accordance with the Treaty establishing the European Communities, as amended by the Treaty on European Union;

"*euro unit*", "*national currency unit*" and "*transitional period*" have the meaning given to those terms in the European Council Regulation on the legal framework for the introduction of the euro which is expected to come into force on 1 January 1999;

"*TARGET*" means the Trans-European Automated Real-time Gross Settlement Express Transfer system.

2. Continuity of contract

The parties confirm that the introduction of the euro or the occurrence or non-occurrence of any other event associated with economic and monetary union in the European Community shall not have the effect of altering any term of the Agreement or discharging, or excusing performance under the Agreement or any Transaction thereunder, nor give a party the right unilaterally to alter or terminate the Agreement or any Transaction thereunder.

3. Business Days

The parties agree that -

(a) references in paragraph 2(d)(iv) of the Agreement to a day on which "banks are open for business in the principal financial centre" in relation to a national currency unit will be to a day on which banks are open for settling payments in the national currency unit in the principal financial centre of that national currency unit immediately prior to the start of the transitional period;

(b) there shall be inserted at the end of paragraph 2(d)(iv) of the Agreement -

"(or, in the case of a payment denominated in euro, a day on which TARGET operates)"; and

(c) the following words at the end of paragraph 2(d)(iv) of the Agreement shall be deleted with effect from 1 January 1999 -

"(or, in the case of ECU, a day on which ECU clearing operates)".

4. Equivalent Securities

The parties agree that for the purposes of paragraph 2(p) of the Agreement, Securities will be equivalent to other Securities notwithstanding that those Securities have been redenominated into euro or the nominal value of the Securities has changed in connection with such redenomination.

5. Payment and Transfer

The parties agree that there shall be inserted at the end of paragraph 6(h) of the Agreement -

> "For the purposes of this paragraph, amounts in euros (whether denominated in the euro unit or a national currency unit) shall be treated as being in the same currency only if those amounts are expressed in the euro unit or the same national currency unit.".

INTERNATIONAL SECURITIES MARKET ASSOCIATION

PSA/ISMA Global Master Repurchase Agreement and the euro

Introduction

A working group of ISMA's CRD repo sub-committee has been established to consider whether any changes are required to the PSA/ISMA Global Master Repurchase Agreement (the "GMRA") in the light of the introduction of the euro.

This paper summarises the key issues and sets out the working group's conclusions. In summary, these are that four changes to the agreement are appropriate (continuity of contracts, the definition of "Business Day", the definition of "Equivalent Securities" and payment netting). A standard form EMU Annex containing these changes is attached to this paper. Other relevant issues discussed in this paper are pricing sources, market conventions and currency conversion.

As always, ISMA recommends that members and other market participants consult with their legal and other professional advisers concerning the use of the EMU Annex.

Continuity of contracts

The European Council has adopted a regulation, the Article 235 Regulation, providing for continuity of contracts. Article 3 of the Article 235 Regulation states that -

> "*the introduction of the euro shall not have the effect of altering any term of a legal instrument or of discharging or excusing performance under any legal instrument, nor give a party the right unilaterally to alter or terminate a legal instrument. This provision is subject to anything which the parties may have agreed.*"

The Article 235 Regulation applies to all EU member states and therefore has effect in English law even though the UK will not participate in EMU at the outset.

The effect of this regulation is that, unless the parties to the GMRA agree otherwise, the continuance of any GMRA and transactions entered into under it will not be affected by the introduction of the euro. This is therefore the position under English law, the governing law of the GMRA.

However, where English law is not recognised as the governing law of the agreement by the courts in the jurisdiction of a counterparty or in any other relevant jurisdiction, it is possible that, under the relevant law, the introduction of the euro could have the effect of terminating the GMRA and transactions entered into under it. In view of this possibility, paragraph 2 of the EMU Annex contains an express provision (based on the wording of the Article 235 Regulation) that the agreement and transactions should not be altered or terminated, and a party will not have the right unilaterally to alter or terminate the agreement and transactions, as a result of the introduction of the euro or the occurrence or non-occurrence of any event associated with EMU.

Pricing sources

As a result of the introduction of the euro, certain existing pricing sources for national currency money markets will cease to exist and be replaced by euro rates, if the currencies concerned participate in the euro area. The pricing source used in the GMRA is LIBOR.

The British Bankers Association ("BBA"), which publishes LIBOR, announced in October 1997 details of a new euro-denominated BBA LIBOR settlement rate which will replace BBA's ECU LIBOR rate from January 1, 1999. The rate will continue to be fixed at 11 a.m. London time on each day on which the TARGET payment system operates. Interest will be calculated on an actual/360 day basis. During the transitional period, the BBA will also continue to publish LIBOR fixings for the seven relevant national currency rates which already have BBA LIBOR benchmarks.

For the purposes of the GMRA, therefore, the euro LIBOR rate will be the relevant pricing source for sums denominated in euro. It is not necessary to amend the GMRA.

Market conventions

As reported in ISMA's annual report for 1997, in July 1997 ISMA and a number of other market associations including ISDA published a joint statement on market conventions for the euro. A copy of this statement is included as the appendix to this paper. This statement was endorsed in September 1997 by the European Monetary Institute ("EMI") and the European Commission.

ISMA considers that references in the GMRA to "the applicable ISMA convention" should, in relation to the euro, be construed as references to the joint statement on market conventions for the euro.

Business Days

There is potential uncertainty as to the operation of paragraph (iv) in the definition of "Business Days" which states that, in relation to an obligation to make a payment otherwise than through Euroclear, Cedel or any other settlement system, a Business Day is a day, other than a Saturday or Sunday, on which banks are open for business in the principal financial centre of the country of which the currency in which the payment is denominated is the official currency or, in the case of ECU, a day on which ECU clearing operates. In the case of a payment denominated in euro, there will be more than one relevant country and it will therefore not always be clear which should be used. In addition, ECU payments will be converted into euro.

Paragraph 3 of the EMU Annex makes clear that references to "a day on which banks are open for business in the principal financial centre" in relation to a national currency unit will be to a day on which banks are open for the settlement of payments in the national currency unit in the principal financial centre of that national currency unit immediately prior to the start of the transitional period. In addition, paragraph 3 amends the definition of Business Days in relation to payments in euro to refer to days on which the TARGET payment system operates (this is every week day except Christmas Day and New Year's Day). The effect of this will be to increase the number of days which are Business Days for the purposes of the GMRA. Paragraph 3 also deletes the reference to payments in ECU with effect from January 1, 1999.

Currency conversion: "Spot Rate"

The GMRA's definition of "Spot Rate" for currency conversion refers to the spot rate of exchange quoted by Barclays Bank. Where a sum is to be converted between a national currency and the euro, conversion must be carried out in accordance with Article 4 of the Article 235 Regulation. This provides that conversion must be carried out at the adopted conversion rates and that amounts to be converted from one national currency unit to another must first be converted into an amount expressed in euro. Alternative methods may only be used if they produce the same result.

The effect of the Article 235 Regulation is that the GMRA definition of Spot Rate may only be used to convert one national currency into another if it produces the same result as the regulation. When converting amounts expressed in national currencies into or from euro, the conversion rates set out in Article 4 of the Article 235 Regulation (or any equivalent method) must be used.

Equivalent Securities

Paragraph 4 of the EMU Annex provides that securities will be equivalent to other securities even though they may have been redenominated into euro or renominalised. This is to make clear that securities which are redenominated from local currency units into euro are equivalent to the original securities, even where the securities have also been renominalised, as the GMRA requires equivalent securities to be of the same nominal value.

Payment netting

Paragraph 6(h) of the GMRA provides for netting of payments of amounts in the same currency. Following the start of Stage 3, this provision could operate to require netting of payments expressed in national currency units of "in" countries (e.g. French francs and Deutschemark) as they will have become different denominations of the same currency (i.e. the euro).

ISMA recommends that in these circumstances, market participants should only net between amounts expressed in the same national currency unit and not between different national currency units, or between national currency units and the euro, notwithstanding that, technically, they are the same currency. This is addressed in paragraph 5 of the EMU Annex.

International Securities Market Association
June 22, 1998

Appendix

ACI – THE FINANCIAL MARKET ASSOCIATION
BANKING FEDERATION OF THE EU
CEDEL BANK
EUROPEAN FEDERATION OF FINANCIAL ANALYSTS' SOCIETIES
EUROPEAN MOTGAGE FEDERATION
INTERNATIONAL PAYING AGENTS ASSOCIATION
INTERNATIONAL PRIMARY MARKET ASSOCIATION
INTERNATIONAL SECURITIES MARKET ASSOCIATION
INTERNATIONAL SWAPS AND DERIVATIVES ASSOCIATION
MORGAN GUARANTY AS OPERATOR OF THE EUROCLEAR SYSTEM (EUROCLEAR)

JOINT STATEMENT ON MARKET CONVENTIONS FOR THE EURO

Economic and Monetary Union presents a number of technical challenges for the international and new domestic (i.e. euro-zone) financial markets. One of these is the need for market participants to prepare for the market conventions that will apply to trading and settlement of the euro money, bond and foreign exchange markets. However, market conventions currently vary across the European Union and there is as yet no agreed set of common conventions for the new single currency. The above named organisations are therefore publishing this joint statement recommending harmonised market conventions for the euro.

Support for Harmonisation

In our views, harmonisation of euro market conventions is desirable, as it would promote liquidity and transparency in the new markets and prevent confusion and disputes for euro trading and settlement. Also, firms and settlement facilities face uncertainty in their systems requirements while this question is left open. We therefore publish the attached bond market, money market and foreign exchange market conventions for the euro with the aim that they establish standards for market practice for the new single currency. We note that parties to a financial contract may always specify their own terms, including day count or other conventions. However, we believe that the attached provide a basis for standard practice, which we strongly recommend to our members and to both public and private issuers of securities. We note that government issuers in particular have an important role to play in achieving harmonisation, by ensuring the use of common standards for euro-denominated benchmark government bond issues.

Treatment of Legacy and Redenominated Instruments

While harmonisation has strong benefits for new euro-denominated instruments, applying, new harmonised, conventions to existing "legacy" instruments - including bonds that redenominate into euro - presents considerable complications. In light of the legal obstacles associated with revising existing agreed conventions and the dangers of hedging mismatches, if underlying and derivative instruments do not all switch to the new conventions, we conclude that existing conventions should be retained for legacy instruments.

Timing

We propose that the attached agreed standards be adopted for financial instruments entered into after the start of stage three of Economic and Monetary Union on 1 January 1999. We also note that new issues before that date of instruments designed to redenominate into euro should also adopt these standards.

CONVENTIONS FOR THE EURO MONEY MARKETS

Day Count Basis

We recommend the adoption of an **actual/360 basis**.

> We note that this is common practice in EU money markets and has been proposed by the European Monetary Institute as the basis for repo instruments used for open market intervention. This convention would apply to wholesale financial activity; we do not recommend a standard retail market convention.

Settlement Basis

We recommend the adoption of a **spot/two day standard**.

> We note that this is the prevalent practice for inter-bank offer rate settlement for most EU currencies.

Fixing Period for Derivatives Contracts

We recommend the adoption of a **two day rate fixing convention** for derivatives contracts.

> Most EU currencies currently provide for a two day period between the fixing of a new floating rate and the date when these new rates become effective (i.e. when the contract actually becomes "reset" to the new rates for the purposes of calculating payments). We believe that this practice should continue and that it would be impractical to shorten this cycle in the near term.

Business Days

We recommend that **TARGET operating days form the basis for euro business days**.

> As a practical matter, we believe that the convention for euro business days and TARGET operating days should be identical, to ensure the availability of euro payments arrangements throughout all EMU area countries on a day identified as a euro business day. In order to facilitate financial activity throughout the EMU area, we recommend that the number of non euro business days be kept to a minimum and possibly be limited to 1 January and 25 December.
>
> We note that this approach has implications for the operating days of commercial and investment banks and other financial market participants in the EMU area and may raise questions concerning national legislation governing bank holidays. It would, for example, mean that institutions unable to make payments specified for a euro business day due to observance of a national holiday would be liable to pay interest for the period of delay.
>
> Finally, we should note that parties to an instrument may well decide to agree to use national business day conventions for the euro, due to the likely absence of full payment services on euro business days in all EMU participant member states (at least in the short term) or if the use of national business days are more convenient for transactions with domestic counterparties.

CONVENTIONS FOR THE EURO BOND MARKETS

Day Count Basis

We recommend adoption of an **actual/actual basis**.

> While many EU markets currently use a 30/360 methodology, in volume terms act/act or act/365 is probably most prevalent in the EU, as it is the convention for French, British and Italian markets. Also, we note that this standard is used in the US and Japanese government bond markets. We note that this is a more exact basis than other methods and presents fewer calculation problems than a 30/360 basis, which largely developed due to systems calculation limitations which have since been overcome.

Quotation Basis

We recommend adoption of **decimals**, rather than fractions, for **bond quotation**.

> Quotations in decimals provide for a more accurate and precise methodology of yield calculation, will unify price quotation for government and corporate debt, as well as being easier for screen displays.

Business Days

We recommend that **TARGET operating days form the basis for euro business days**.

> Please refer to the commentary above on euro business days in money markets.

Coupon Frequency

We do not recommend a standardised practice in this area.

> In our view, there are strong arguments for the use of either a semi-annual or annual payment basis as the standard for euro coupon frequency. Semi-annual coupons reduce the credit exposure of investors to issuers and on swaps linked to bonds. They are also attractive to institutional investors seeking regular income. In volume terms, it is the standard most widely used globally, employed in the US, Japan, UK and Italy. On the other hand, annual coupons are used by most EU countries, involve lower administrative costs and are attractive to some issuers and investors.
>
> The competing merits of both payment bases, combined with a desire to allow flexibility to respond to issuer and investor preferences, leads us to conclude that in this particular area the case for harmonisation is less compelling. While the individual organisations have made recommendations in this area, the group does not recommend a standardised practice for coupon frequency.

Settlement Dates

We recommend that the standard settlement date for internationally traded cross-border transactions for the euro remain on a **T plus 3 business day cycle**.

> While we note that special value dates may be agreed between buyer and seller, we feel that the current T plus 3 day cycle currently in force should be retained for the euro. However, with the soon to be introduced real time gross settlement systems and the ever-increasing desire to reduce settlement risk, we believe that a move to ever shortening settlement cycles is inevitable. Nevertheless, we feel that it would be inappropriate to introduce such a change at the current time, due to other significant system changes posed by the introduction of the euro.

CONVENTIONS FOR THE EURO FOREIGN EXCHANGE MARKETS

Settlement Timing

We recommend the adoption of a **spot convention**.

> International markets should move to a spot convention for settlement of foreign exchange transactions of the euro and interest accrual should then begin on the second day after the deal has been struck.

Foreign Exchange Quotation

We recommend the adoption of the rule of **'certain for uncertain'**.

> In our view, the methodology for the quotation of foreign exchange rates should follow the rule of 'certain for uncertain' (i.e. 1 euro = x foreign currency). It may not be appropriate to harmonise domestic retail market conventions. This should be left to subsidiarity.

Reference Rate

We recommend that the **ECB (or its national central banks) should be responsible for the publication of a daily reference rate**.

> There would be advantages in having one authoritative closing reference rate, produced at an appropriate time each day and published through a well known and established medium (e.g. a major screen based service).

16 July 1997