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GUIDANCE NOTES FOR USE WITH THE PSA/ISMA GLOBAL MASTER REPURCHASE AGREEMENT (NOVEMBER 1995 VERSION)

These guidance notes:

- are designed to assist users of the PSA/ISMA Global Master Repurchase Agreement (the *"Agreement")* in completing the Agreement and in arranging transactions under the Agreement;
- do not form part of the Agreement; and
- summarise the key provisions of the Agreement but are not intended to summarise all of the provisions of the Agreement.

A. INTRODUCTION

The Agreement has been produced by the Public Securities Association *("PSA")* and the International Securities Market Association *("ISMA").* The Agreement has been prepared as a stand?- rd form and any person proposing to use it should ascertain that it is suitable for the circumstances in which it is proposed to be used. Neither the PSA nor ISMA assume responsibility for use of the Agreement or any of the annexes in any particular circumstances. Parties using the document may wish to incorporate amendments. However, PSA and ISMA will only permit this document to be used in an amended form if the amendments are made in such a way that they are clearly identifiable, for example by a side letter or mark-up.

The Agreement was first published in November 1992 and the revised version (to which these guidance notes relate) was published in November 1995. The revised version has been produced in conjunction with ISMA's Council of Reporting Dealers Repo Sub-Committee.

As with the standard form master repurchase agreement prepared by the PSA for use in the US repo market, the Agreement provides market participants with a substantial degree of flexibility in structuring the commercial aspects of both the Agreement and transactions made under it. For ease of reference a note of the matters which the Agreement expressly leaves to be agreed between the parties in respect of the Agreement as a whole appears in Annex I, while a note of equivalent matters in respect of particular transactions appears in Annex II (which provides the form of confirmations).

The Agreement is designed for use for repurchase transactions (repos) but may also be used for buy/sell back transactions. Annex III contains additional terms applicable to buy/sell back transactions effected under the Agreement. Use of the Agreement for buy/sell backs may help parties, where documentation is required, to obtain the most favourable capital treatment of transactions under the European Union Capital Adequacy Directive.

B. SPECIFIC COMMENTS

1. Non-UK parties

This Agreement has been drafted with a view to compliance with United Kingdom legal and regulatory restrictions and on the basis of the application of United Kingdom taxation. If this Agreement is used by parties who are subject to other legal, regulatory or taxation regimes, local legal, regulatory and taxation advice in the relevant jurisdictions should be sought.

2. Bank of England Grey Paper regime

The regulatory position of UK parties to this Agreement will depend upon whether they are for these purposes regulated by the Securities and Futures Authority (SFA) or by the Bank of England under its "Grey Paper" regime which includes the London Code of Conduct. In order for the Grey Paper regime to apply in respect of a party the following criteria must be satisfied:

- that party must be on the Bank of England's list of listed money market institutions for the purposes of section 43 of the Financial Services Act 1986 (the *"Act");*
- the transactions must fall within the scope of Parts I and II of Schedule 5 to the Act. Accordingly short term transactions (under 12 months) in respect of investments falling within paragraph 2 (debentures) or 3 (government and public securities) of Schedule I to the Act are permitted provided the counterparty is also a listed money institution (Schedule 5 Part I paragraph 3(1)) or provided the consideration is not less than f500.000 (Schedule 5 Part II paragraph 4(1)).

3. Gilt repo

The Bank of England's Gilt Repo Legal Agreement Working Party has prepared a set of standard supplemental terms and conditions for use in repos in UK gilt-edged securities (gilts), the market in which is to start on 2 January 1996. These terms are in the form of a Part 2 of Annex I of the Agreement. In addition, the Bank of England's Gilt Repo Code Working Party has produced a Code of Best Practice for repo transactions in gilts.

4. Withholding tax

The Agreement should be used only with gross paying securities, i.e. where the coupon on the securities may be paid by the issuer gross in all circumstances and the paying or collecting arrangements made in relation to the coupon do not result in the seller receiving the coupon under deduction of UK tax. Equally, any margin securities which are to be held across a coupon date or record date should be gross paying securities. The representation in paragraph 9(i) has been introduced to obtain confirmation that the paying and collecting agency arrangements do not result in the coupon being subject to deduction in respect of UK tax. If this representation cannot be given in relation to both purchased securities and margin securities in respect of any transaction then the securities should not be treated as gross paying securities and this Agreement should not be used. Where there is any withholding in respect of income payments on any relevant securities, UK tax provisions can apply to impose withholding tax in respect of manufactured payments under paragraph 5. The Agreement does not attempt to address the consequences of this.

5. Withholding: repo return and cash margin

The UK 1995 Finance Act contains a provision which deems the differential between the sale price and the repurchase price under a normal repo transaction to be "interest" for UK tax purposes on a deemed loan made by the buyer to the seller. Parties should take their own advice as to whether a transaction or series of transactions could or might give rise to annual interest. If interest is "annual" or "yearly" interest then, subject to various exceptions (including where one of the parties is an Inland Revenue recognised bank), it will be payable subject to withholding of UK basic rate income tax (currently 25%) where it has a UK source (broadly, where the seller is UK tax resident or trading in the UK). Paragraph 6(b) places a liability on the payer of the interest (i.e. the seller) "unless otherwise agreed", to gross up in respect of any withholding.

Similarly, interest payable under paragraph 4(f) in respect of cash margin may, if it is annual, be payable subject to withholding if it has a UK source.

6. Agency Transactions

The Agreement contains an annex, Annex IV, which permits one party to act as agent for an identified principal and which contains additional provisions required for agency transactions. The provisions permit a party to act as agent for more than one principal and as principal for its own account provided that each agency transaction is specified as such at the time at which it is entered into and is effected for a single designated principal whose identity is disclosed to the other party.

The annex contains a provision whereby a party is entitled to call an event of default if an event of default occurs in relation to the agent.

The agency annex does not cover transactions for unnamed principals, block transactions (i.e. single transactions which are allocated among two or more underlying principals) or transactions which are to be allocated to principals after they have been entered into.

In the interests of simplicity, the agency annex does not permit transactions where both parties are acting as agents.

7. Base currency

The parties must determine the base currency for the Agreement by specifying it in Annex I. Base currency is used for the purposes of the set-off provisions and the margining provisions of the Agreement. The choice of base currency is a matter for the parties. Relevant factors are likely to include the location and jurisdiction of incorporation of the parties and the currency of the purchase and repurchase prices and of the securities likely to be covered by the Agreement. Parties should note that an exchange rate exposure may arise in some circumstances on the insolvency of a counterparty where the base currency is not the currency of the place of incorporation. This is because, in the event that the counterparty goes into liquidation and the non-defaulting party seeks to prove for any excess owed to it after the set-off provisions have been applied in accordance with paragraph 10(c)(ii) if that figure is expressed in a currency other than the currency of the place of incorporation of the counterparty, the law applicable to the liquidation may require its conversion into that currency.

C. PROVISIONS OF THE AGREEMENT

Applicability (paragraph 1)

This paragraph sets out the general scope and applicability of the Agreement. It contemplates the inclusion in Annex I of supplemental terms and conditions and written modifications of the Agreement. Annex I provides a note of the matters which are expressly left to be agreed between the parties in the Agreement and also permits additional supplemental terms and conditions to be included.

If it is intended that the parties will carry out buy/sell backs and/or agency transactions under the Agreement, this must be stated in Annex I, and, if so, the provisions of Annex III (for buy/sell backs) and Annex IV (for agency transactions) will be applicable. If parties do not wish the Agreement to be used for these transactions, the relevant paragraph in Annex I should be deleted.

Definitions (paragraph 2)

"Act of Insolvency" (paragraph 2(a))

This definition includes those events to be considered to be clear indications of a counterparty's inability to perform its obligations under an Agreement of this type.

"Default Market Value" (paragraph 2(j))

This definition is used for calculating the value of the obligations of the buyer to the seller when, following an event of default, set-off is being applied. The paragraph defines the "Default Valuation Time" as the close of business in the most appropriate market for the securities in question (as determined by the non-defaulting party) on the day following the day of default (if the default occurs during business hours on a dealing day in that market) or (if not) the following dealing day. The default valuation time may therefore differ (in absolute terms) between different securities traded in different time zones. The Agreement provides that if the non-defaulting party actually deals in that market before the default valuation time, the price which he obtains is the default market value. Otherwise the default market value is the best price reasonably obtainable on that market at the default valuation time.

"Designated Office" (paragraph 2(l))

The Agreement requires parties to specify the branches or offices through which they will enter transactions to be governed by the Agreement. This will enable parties, for credit and regulatory capital purposes, to enter into transactions only through branches or offices in jurisdictions in respect of which legal opinions as to the efficacy of the netting provisions of the Agreement have been obtained.

If parties use a branch or office in another jurisdiction, supervisors may not recognise the netting provisions of the Agreement for capital adequacy purposes with the consequence that gross exposures to counterparties may be required to be taken into account.

"Income" (paragraph 2(s))

Annex I contains at paragraph I(e) an optional provision which excludes from the definition of Income any sums deducted at source in respect of tax in relation to Italian government bonds.

"Market Value" (paragraph 2(y))

This definition is used for the purposes of margining and substitution. In the case of suspended securities, paragraph 2(y) provides that the value of such securities (for the purposes of the margining calculations in paragraph 4 only) will be nil, so that the suspension of purchased securities will or may cause a transaction exposure in respect of the transaction concerned. However, it would be clearly inequitable for the purposes of set-off or substitution for the value of such securities to be nil and accordingly for these purposes the value is treated as the market value of the relevant securities on the business day immediately preceding the date of suspension.

"Price Differential" (paragraph 2(dd))

In order to calculate the price differential for a transaction, the parties are required to apply the pricing rate to the purchase price on a 360 day or 365 day basis in accordance with the applicable ISMA convention which determines whether interest is calculated in any jurisdiction on the basis of a 360 or 365 day year.

initiation; confirmation; termination (paragraph 3)

This paragraph describes the mechanics of initiating, confirming and terminating a transaction. The Agreement contemplates that either party may initiate a transaction orally or in writing and that one or both parties (depending on whether the transaction is between a dealer and a customer, or between two dealers) shall deliver a written confirmation. The confirmation may be substantially in the form of Annex II and must contain certain prescribed information together with such additional terms as the parties may agree.

In the case of a buy/sell back transaction, Annex III permits the parties to deliver a single confirmation which relates to both legs of the buy/sell back transaction or a separate confirmation for each leg of the transaction. The confirmation or confirmations relating to a buy/sell back transaction must specify the pricing rate applicable to that transaction.

If a transaction is a buy/sell back transaction and/or an agency transaction, this must be specified in the confirmation.

Termination of demand transactions may be initiated by either the buyer or the seller. Termination will occur after not less than the minimum period customarily required for settlement or delivery of money or equivalent securities of the relevant kind from the date of demand.

Margin maintenance (paragraph 4)

The Agreement fixes the amount of margin at the outset of each transaction by reference to the value of the securities at the purchase date and the purchase price to give the "Margin Ratio", which is defined as the market value of the purchased securities at the time when the transaction was entered into divided by the purchase price. The parties may choose a different margin ratio for any or all transactions entered into under the Agreement.

If a transaction relates to different types of securities and the parties attribute the purchase price among the different types, the definition of margin ratio permits a separate margin ratio to be applied to each type of security.

This paragraph requires margin to be calculated on a global basis for all transactions outstanding under the Agreement to give an overall "Net Exposure".

A margin call is satisfied by making a "Margin Transfer" which may be by way of cash or securities. The combination of cash and securities in any margin transfer is at the option of the party making the transfer, but any securities transferred must be reasonably acceptable to the other party. Where cash is transferred, the parties may specify the currency, the rate at which interest shall accrue on that cash and the interest payment dates.

The parties may elect not to include a particular transaction in the global margin calculation but instead to provide margin separately in such manner as the parties shall agree.

The parties may also elect to reprice a transaction rather than apply the margin maintenance provisions. A repricing may be achieved by way of adjustment to the purchase price or the securities.

Paragraph 4(j) provides for the elimination of an exposure by, in effect, adjusting the repurchase price for the securities. This is done by terminating the original transaction and replacing it with a new transaction in which the purchased securities are equivalent to the purchased securities in the original transaction. The purchase price for the new transaction shall be the market value of those securities at the date of the repricing as adjusted by the margin ratio. The repurchase date, the pricing rate and the margin ratio are identical to those of the original transaction.

Paragraph 4(k) provides for the elimination of an exposure by, in effect, adjusting the identity and/ or the amount of the securities. This is done by terminating the original transaction and replacing it with a new transaction in respect of new securities with a market value substantially equal (recognising that some discrepancy may arise from the need to deliver convenient quantities of the new securities) to the repurchase price under the original transaction (that is, the original purchase price as increased by the price differential accrued up to the date of the adjustment). The parties will need to agree the identity of the new securities at the relevant time; they may include some or all of the securities purchased under the original transaction, in which case only those deliveries of securities necessary to reflect the differences will be made.

In the case of repricing by way of adjustment to the securities, paragraph 4(k)(i) provides that the original transaction shall be terminated on the adjustment date on such terms as the parties shall agree and, except for the items specified in paragraph 4(k), the terms of the new transaction shall also be agreed by the parties.

This leaves the parties with flexibility to effect the adjustment in whichever way they wish. For example, if the parties wish to avoid either an early payment of the price differential on the original transaction or compounding of the pricing rate, they can provide for the purchase price under the new transaction to be equal to the purchase price of the original transaction. The price differential for the new transaction would then be adjusted by adding the accrued price differential in respect of the original transaction.

Income payments (paragraph 5)

This paragraph provides that when a transaction extends over an income payment date the buyer will on the date of the income payment transfer to the seller an amount equal to that income payment. A similar provision applies to margin securities held over an income payment date.

Payment and transfer (paragraph 6)

This paragraph deals with the transfer of title and with the practicalities of payment and transfer.

All transfers of securities under the Agreement (whether on the first or second leg of a transaction or by way of transfer, adjustment or return of margin) pass absolute title to those securities to the transferee.

The provisions for the method of the transfer of securities are flexible; the method of transfer may be as agreed between the parties (sub-paragraph 6(a)(iv)).

All monies payable must be paid in gross unless withholding or deduction is required by law (paragraph 6(b)). In that case, there must be a "grossing up".

Contractual currency (paragraph 7)

All payments made in respect of the purchase price and the repurchase price must be made in the contractual currency (i.e. the currency specified on a transaction by transaction basis). The contractual currency should be distinguished from the base currency which is specified (in Annex I) for the purposes of the Agreement as a whole, and which is used in the calculation of set-off and margin (paragraph 10(c)(ii)).

Substitution (paragraph 8)

This permits the seller or the transferor of margin, if the parties agree, to substitute other securities for any purchased securities or margin securities. The new securities must have a market value at least equal to the securities which they replace.

Representations (paragraph 9)

This paragraph includes the customary representations for agreements of this type. Representation (b) is that each party will engage in transactions as principal (unless the transaction is an agency transaction).

If a transaction is not an agency transaction, it is important that this representation can be given in order for the set-off mechanism in paragraph 10 to be effective. In order for set-off to be effective on the insolvency of a UK party to the Agreement, the debts owed by and to each party must be owed by and to it acting in the same capacity.

Where one party is acting as an agent and Annex IV applies, representation (b) is amended to include a representation that the party has complied with the conditions of Annex IV, one of which is that an agent is required to enter into a transaction on behalf of a single principal and to identify that principal to the other party. This ensures that the capacity in which the agent is acting and the extent to which set-off is available against the principal is clear.

Representation (g) is a representation that each party is not relying on the advice of the other, that it has made its own decisions regarding the entering into of any transactions under the Agreement and that it understands the terms, conditions and risks of each transaction. Each party should check whether this representation is accurate, both at the time of entering the Agreement and any transaction.

Events of default (paragraph 10)

This paragraph specifies eight events of default that may be (broadly) summarised as follows:

- failure to pay the purchase price on the purchase date or the repurchase price on the repurchase date;
- failure to comply with the margin maintenance provisions;
- failure to pay manufactured dividends;
- act of insolvency;
- incorrect or untrue representations;
- admission by a party of its inability or intention not to perform obligations under the Agreement;
- suspension from membership of regulatory organisation etc.; and
- failure to perform other obligations under the Agreement which is not remedied after thirty days' notice by the non-defaulting party.

Except in the case of certain acts of insolvency (where default is automatic) the non-defaulting party has the discretion to decide whether these events are to be treated as events of default giving rise to termination of the Agreement. If it decides to treat an event as an event of default he must serve a notice to that effect (a "Default Notice") on the other party.

The occurrence of an event of default has the effect of accelerating outstanding transactions, converting delivery obligations in respect of securities to cash sums based on the market value of those securities (converted into the base currency where necessary) and then applying set-off. Any balance outstanding after set-off has been applied will be payable on the next following business day. The defaulting party will be liable for the non-defaulting party's expenses in connection with the event of default, together with interest.

Failure to deliver the purchased securities to the buyer on the purchase date or to deliver equivalent securities to the seller on the repurchase date is not an event of default, but the other party is entitled to:

- require the repayment of the purchase price or repurchase price if it has paid it; or
- if it has a transaction exposure in respect of the relevant transaction, require the payment of cash margin; or
- by written notice, declare that that transaction only shall be terminated.

Paragraph 10(g) contains a statement that the provisions of the Agreement contain a complete statement of the remedies available to each party in respect of an event of default and paragraph 10(h) states that neither party may claim any sum by way of consequential loss or damage if the other party fails to perform any of its obligations under the Agreement.

The parties are free to agree further events of default (e.g. cross-default, credit related events etc.) if they so wish.

Tax event (paragraph 11)

This paragraph provides that in the event of any action taken by a revenue authority or brought in a court of competent jurisdiction or a change in tax law or practice which has a material adverse effect on a party in the context of a transaction, that party may elect to terminate that transaction. If it does so elect, the other party may override the election to terminate the transaction, but in so doing will agree to indemnify the affected party against the adverse effect.

Interest (paragraph 12)

This paragraph provides for interest to accrue on late payments.

Single agreement (paragraph 13)

This paragraph provides the acknowledgement that the Agreement and each transaction under it constitute a single contractual relationship. These provisions may assist in establishing that set-off is available in the event of non-UK insolvency proceedings.

Notices and other communications (paragraph 14)

These are standard provisions in agreements of this type.

Entire agreement; severability (paragraph 15)

These are standard provisions in agreements of this type.

Non-assignability; termination (paragraph 16)

It is provided that rights and obligations under the Agreement and/or any transactions are not assignable without the consent of the non-assigning party. It should be noted that any assignment may affect the enforceability of the set-off provisions in the event of a party's insolvency.

There is one exception to this prohibition. Paragraph 16(b) permits a party to assign its right in a net sum payable to it following termination after an event of default.

Governing law (paragraph 17)

The Agreement is governed by English law and the parties submit to the jurisdiction of the English courts. This is without prejudice to the ability of any party to take proceedings in courts of other countries of competent jurisdiction.

There is provision for the appointment of process agents; this will be appropriate where one or more party does not have an office in the UK.

No waivers etc. (paragraph 18)

These are standard provisions in agreements of this type.

Waiver of immunity (paragraph 19)

These are standard provisions in agreements of this type.

Recording (paragraph 20)

Each party consents to the tape recording of telephone calls between them. This is recommended by the Bank of England's London Code of Conduct.

Buy/sell back transactions (Annex III)

This annex enables the Agreement to be used for buy/sell back transactions and contains the amendments to the Agreement for these transactions.

The transaction must be identified as a buy/sell back in the confirmation. As noted above, the confirmation relating to a buy/sell back may be in the form of a single document or two separate confirmations. The confirmation (or at least one of them where there are two) must specify the pricing rate applicable to the transaction.

Buy/sell back transactions are not terminable on demand. The purchase price and the sell back price are to be quoted exclusive of accrued interest.

Where a buy/sell crosses an income payment date the buyer does not have the obligation to make a manufactured payment to the seller equivalent to the coupon. There is instead an adjustment to the sell back price to reflect the fact that the seller will not receive a manufactured coupon. If section 737A Taxes Act 1988 applies, the buyer can be deemed to have made a manufactured payment in these circumstances and adverse UK tax consequences may arise. Section 737A is not, as at 3 November 1995, in force in relation to "overseas securities", which will include most non-UK securities (although it is in force in relation to UK equities and gilts). However, discussions between the Inland Revenue and the market in this area are currently taking place.

Agency transactions (Annex IV)

An agency transaction is a transaction in which one of the parties is acting as agent for an identified principal. As noted above, the Agreement does not cover transactions for unnamed principals, block transactions or transactions which are to be allocated to principals after they have been entered into. The annex does not permit transactions where both parties are acting as agents.

A party may only enter into an agency transaction if it is acting on behalf of a single principal and discloses the identity of the principal (either by name or by reference to a code or identifier). The agent must also have authority to enter into the transaction on behalf of the principal and authority to perform all of the principal's obligations under the Agreement. The confirmation relating to an agency transaction must specify that it is an agency transaction.

An agency transaction is deemed to be entered into between the other party and the principal on whose behalf the agent has entered into the transaction. The provisions of the Agreement apply as between the principal and the other party as if the principal were a party to a separate agreement on the same terms.

If an event of default occurs in relation to the agent, the other party may elect that it shall be treated as an event of default in respect of the principal. This is because, although the non-defaulting party should be protected legally in the event of the insolvency of the agent (as the transaction is with the principal and not the agent), it may, as a practical matter, be difficult to enforce rights where the agent has defaulted.

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