

TBMA/ISMA GLOBAL MASTER REPURCHASE AGREEMENT (2000 VERSION)

Guidance notes to the Equities Annex

These guidance notes -

- are designed to provide users of the Equities Annex with information on its content;
- do not form part of the Equities Annex or the Agreement; and
- summarise certain, but not all, of the provisions of the Equities Annex.

Introduction

1.1 The text of the Agreement was produced primarily with debt securities, and particularly government debt securities, in mind. Its use with other securities often necessitates additional provisions. This is the case with equities (hence the specific exclusion of equities from the Agreement).

1.2 The Equities Annex contains additional provisions for inclusion where either the Purchased Securities or Margin Securities are equities. The Equities Annex is designed to document Transactions which involve transfers of cash against transfers of “general collateral” which include equities or transfers of equities as Margin Securities. Users of the Equities Annex should, however, always satisfy themselves that these provisions are adequate and appropriate in the context of the particular transactions they propose to enter into and the particular securities which they propose to use.

1.3 The provisions of the Equities Annex contemplate:

- additional events which may affect equity securities during the life of a transaction;
- the payment of income on securities otherwise than in cash;
- a methodology for dealing with the tax issues relating to manufactured dividends which may arise in respect of equities;
- voting rights;
- transfer taxes;
- arrangements that may apply to settlements of equities.

Equities and Equivalent Securities

2.1 Paragraph 2 of the Equities Annex contains three important definitions, namely, of the terms “equities”, “Equivalent Margin Securities” and “Equivalent Securities”.

2.2 Users of the Equities Annex should ensure that the types of equity securities with which they propose to deal fall within the definition of equities.

2.3 The definitions of Equivalent Securities and Equivalent Margin Securities anticipate the possibility of corporate events and other similar events affecting the equities involved. Examples are conversions, takeovers and rights issues. These definitions are based on the corresponding definitions contained in the standard securities lending documentation issued by the International Securities Lenders Association (ISLA).

2.4 Many corporate or other events effect some change to the securities concerned (e.g. a conversion). In many cases the securities will have been substituted before the corporate or other event occurs, but if they have not been then the question that arises is what equivalent securities should be returned. These definitions answer that question. They also address the situation where the event involves a choice being made or a payment being made.

Taxation

3.1 Paragraph 3 of the Equities Annex substitutes a new and expanded paragraph 5 of the Agreement, designed particularly to deal with the position in relation to payments of Income if a repo of equities spans an Income Payment Date or an Income Payment Date arises whilst equities have been transferred as Margin Securities.

Non-Equities

3.2 The new and expanded paragraph 5 deals with payments of Income in a special manner described below. However, new sub-paragraph 5(a) is identical to the existing paragraph 5 of the Agreement except for the introduction of the words "which are not equities" in each of sub-paragraphs (i) and (ii). The reason for including this sub-paragraph in the Equities Annex is that it will not necessarily be the case, where this Annex is used, that all the securities that are involved are equities needing to be dealt with under special rules. For example, there could be a case where the securities that are repoed are equities but Margin Securities are debt securities, which may include net paying debt securities in respect of which the parties have agreed that paragraph 1(b) of Annex I (Net Paying Securities) shall apply. In such a case paragraph 5(a) will have the effect of making it clear that, in the absence of any agreement to the contrary, any manufactured payments falling to be made in respect of the debt securities are to be made on a gross basis as is the normal rule under the Agreement.

Equities

3.3 The general rule established by sub-paragraph 5(b) is that unless otherwise agreed, equity securities will be recalled prior to a dividend date, ideally by way of an agreed substitution.

3.4 *What is payable if an Income Payment occurs?* The background to the inclusion of this general rule can best be understood by first considering sub-paragraph 5(c). The underlying approach of the Equities Annex is that if an Income Payment Date occurs while securities are out on repo, the cash provider in an equity repo (the Buyer) should not normally have to pay over more than the amount receivable by him in respect of a payment of Income on the equities. In particular, in normal circumstances, the Buyer should not have to pay over a full gross amount to the Seller if in fact the amount receivable by the Buyer is net of withholding tax.

3.5 Accordingly, the drafting approach of sub-paragraph 5(c) is as follows. It stipulates as the normal rule that, where equities are out on repo over an Income Payment Date, the amount of the manufactured payment payable by the Buyer is the amount of cash received by him (net of any withholding tax deducted at source), plus any amount which the Buyer is entitled to recover from the source jurisdiction of the equities in respect of tax. If the Buyer has disposed of the equities at the relevant Income Payment Date, the paragraph 5 payment is calculated by reference to the amount that would have been obtained if the Buyer had retained them.

3.6 No amount is payable under paragraph 5(c) in respect of irrecoverable withholding tax suffered in the jurisdiction of issue, nor by reference to any tax credit benefit which the Buyer might be accorded by the authorities in its own jurisdiction.

3.7 *The preferred solution:* Given that background, a Seller is likely to prefer to take back securities over an Income Payment Date, for example where the amount which the Seller itself would receive if it held the equities at the Income Payment Date would exceed the amount which the Buyer would have to hand over to the Seller under the normal rule in paragraph 5(c) as outlined above.

3.8 Accordingly, paragraph 5(b) provides that, unless otherwise agreed, a Seller will seek to effect a substitution of equities which would otherwise still be out on repo over an Income Payment Date. As with any substitution, this will require the Buyer's agreement to it. If no substitution has been effected, the relevant Transaction will terminate before the Income Payment Date. It is recognised that a Seller should be responsible for monitoring the dividend payment dates relating to equities which he has transferred by way of repo. Accordingly, such a termination before an Income Payment Date will only occur if the Seller has given the Buyer notice under paragraph 5(b)(iii) of the impending Income Payment Date and requested the retransfer of the equities.

3.9 If the Seller has given such a notice to the Buyer, but the Buyer has failed to make reasonable attempts to transfer equivalent equities to the Seller before the Income Payment Date, the proviso to paragraph 5(c) requires the Buyer to indemnify the Seller against loss caused by the failure to transfer.

3.10 *Margin Securities:* Equivalent provisions to those discussed above apply in the case of Margin Securities which are equities. In particular, paragraph 5(b)(ii) will provide for the transfer of Equivalent Margin Securities to the transferor if the transferor has given a notice to the transferee under paragraph 5(b)(iii) and provided the transferee with appropriate additional information. In such circumstances, in addition, the transferee will need to agree to the substitution request.

3.11 *Inter-relationship with normal gross-up clause:* Paragraph 5(d) is designed to govern the relationship between the normal gross-up clause in the Agreement (paragraph 6(b)) and the position as described above. The effect of paragraph 5(d) is as follows. The Buyer will not, if it has to account for any tax when making a payment in respect of equities pursuant to paragraph 5(c), normally be required to pay an additional amount by way of gross-up under paragraph 6(b) if some withholding is required on making the payment to the Seller. This is consistent with the view that generally, the Buyer's position should, as cash provider, be protected under an agreement to repo equities. An exception is made in a circumstance where, in relation to the Income payment on the equities in question, the Buyer can obtain a tax credit which means that the withholding or deduction does not amount to a true cost for the Buyer. In such a circumstance, the gross-up clause is reinstated.

3.12 *Contrary Agreement:* It should be noted that these provisions of the Equities Annex are expressly subject to any contrary agreement the parties may reach as to the matters in question.

3.13 *Country Specific Requirements:* The Equities Annex does not attempt to deal specifically with the position of UK equities. Participants who are contemplating using the equity repo annex for transactions in UK equities will, as with any transaction, need to check the position carefully in the specific context of any particular proposed transaction. Amongst the questions to be considered will be the detail of the stamp duty and stamp duty reserve tax position and also whether, in any particular case, the Buyer may be in a position to claim any amount from the UK authorities that could be within sub-paragraph (c)(ii), for example under the terms of an applicable tax treaty.

Voting Rights

4. Where voting rights fall to be exercised in respect of equity securities which have been repoed or used as margin, paragraph 4(b) provides that neither the Buyer (in the case of Purchased Securities) nor the transferee of Margin Securities has any obligation to arrange for voting rights to be exercised unless the parties agree otherwise.

Transfer Taxes

5. Paragraphs 5(a) and (b) allocate responsibility for transfer taxes between the parties.

Settlement Systems

6. Where the settlement system through which securities are being transferred creates a payment against transfer of the relevant securities, paragraph 5(c) provides a mechanism for return of the cash to the extent that it is not appropriate for it to be retained by the recipient.

February 2003