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## **Master Securities Loan Agreement**

### **Guidance Notes for European Economic and Monetary Union Amendment**

The Bond Market Association (the “Association”) has prepared an Euro Amendment to the MSLA (“MSLA”) to address the European economic and monetary union and the introduction of the single European currency (“EMU Amendment”).

These guidance notes summarize some of the key provisions of the EMU Amendment and identify certain additional issues that parties may wish to consider in connection with the euro and related developments. The following discussion should not be relied upon by any party to determine, without appropriate legal, tax, accounting or other professional advice, whether the EMU Amendment is suitable for all circumstances and counterparties using the MSLA or whether modifications to the EMU Amendment are required to address issues raised by specific transactions. Capitalized terms used but not otherwise defined in these guidance notes have the meanings given to them in the MSLA.

#### **1. Continuity of Contracts**

New York State’s General Obligations Law was amended in 1997 to ensure the continuity of contracts after the European economic and monetary union. The New York State statutory provisions, which are codified at Sections 5-1601-1604 of the General Obligations Law, provide that the introduction of the Euro shall not have the effect of discharging or excusing any performance under any contract, security or instrument, or give a party a right to unilaterally alter or terminate any contract, security or instrument. The intent of these provisions, which mirror the language of Article 3 of the Article 235 adopted by the Council of the European Union (“EU Council”), was to ensure the continuity of contracts after the introduction of the euro by preventing parties from invoking common law doctrines such as frustration or impossibility, or the commercial law doctrine of impracticability, as a way of terminating or otherwise discharging their obligations due to this event.

The purpose of the continuity provision in the EMU Amendment is to confirm the position of continuity of contracts embodied by the legislative provisions within the contract itself and to clarify the position in the event that parties using the MSLA have agreed to have the contract governed by laws other than the State of New York.

The amended General Obligations Law also provides that if a subject or medium of payment of a contract, security or instrument is ECU, the euro will be a commercially reasonable substitute and substantial equivalent. Pursuant to EU Council Regulations, the ECU will be converted to euro at a ratio of 1:1. Therefore, ECU denominated obligations under the MSLA should be unaffected.

#### **2. Identical Securities and Equivalent Securities Collateral**

To avoid any doubt, the EMU Amendment clarifies that regardless of any redenomination, renominialization or reconventioning of securities that may occur in connection with the conversion to euro, they will continue to be treated as Loaned Securities or securities Collateral for all purposes under the MSLA.

### 3. Transfers of Cash

The EMU Amendment amends the provisions of Section 16 that govern the method for making transfers of cash payments and the days on which such payments may be made to explain how the provisions should apply in the case of payments denominated in euro that are made through the new TARGET system. TARGET is the inter-bank funds transfer system that will handle large transfers of euros and will link to domestic funds transfer systems in the participating euro countries. It is currently anticipated that the only holidays on which TARGET will be closed are Christmas and New Years Day.

Market participants conducting securities lending transactions in business centers such as New York or London should bear in mind that they may have an obligation under the EMU Amendment to make euro-denominated payments on a day when their offices in that location may be closed for business.

Section 26.2 of the MSLA, which defines the term “Business Day”, does so by reference to days on which trading occurs in respect of Loaned Securities or securities Collateral. Therefore, this definition did not need to be amended to accommodate the euro currency conversion.

### 4. Currency Conversion and Valuation Calculations

The MSLA currently provides a method for doing currency conversions based on the amount of one currency a party can buy with another currency consistent with normal banking procedures. However, two regulations of the EU Council mandate specific conversion methods in particular situations. First, Council Regulation (EC) No. 2866/98 irrevocably fixed conversion rates between the participating national currencies and the euro, so all conversions from a national currency into euro or from euro into a national currency need to be conducted at these fixed rates. Second, Article 4(4) of Council Regulation (EC) No. 1103/97 specifies how conversions between two national currencies that are denominations of the euro must be conducted. Alternative methods are permissible only if they produce the same result. The language of Section 17.1 has therefore been modified to incorporate these regulatory requirements in Section 5 of the EMU Amendment. In addition, Section 6 of the EMU Amendment implements this requirement for purposes of the valuation provisions of the MSLA.

Section 5 of the EMU Amendment also contains a number of provisions clarifying how Contractual Currency is to be construed in connection with the conversion to euro. First, the Amendment recognizes that during the transition period (until January 1, 2002) the principle of “no compulsion, no prohibition” applies and national currencies of participating countries will continue to be valid legal tender along with the euro. National currencies will be expressed as denominations of euro. Therefore, amounts in two national currencies of participating countries could be considered to be the same currency, as they are both denominations of the euro. However, to simplify operational aspects of payments and transfers of funds during the transition period, amounts will be considered expressed in the same currency only if they are expressed either in euro or the same national currency unit.

A number of trade associations and other industry groups have recommended a “Big Bang” approach to conversion, whereby all cash payments in respect of securities denominated in the national currency of a member state adopting the euro will be made in euro, whether or not the underlying security to which the payment relates has been redenominated by the issuer. The EMU Amendment seeks to facilitate firms’ use of the “Big Bang” approach in two ways. First, the EMU Amendment recognizes that if securities that are the subject of a Loan or serve as collateral for a Loan are redenominated into euro during the term of a Loan, the Contractual Currency for purposes of making payments will be considered to be euro, unless otherwise

agreed, regardless of the fact that the securities may have been denominated in a national currency at the inception of a Loan. Return of cash Collateral, however, will continue to be in the currency in which originally pledged, regardless of any redenomination of the Loaned Securities, unless otherwise specifically agreed by the parties.

In addition, where securities that are the subject of a Loan or serve as Collateral for a Loan have not yet been redenominated, the EMU Amendment contains a provision to clarify parties' obligations in respect of payments and distributions if they choose to adopt a "Big Bang" conversion approach and make cash payments in euro.

## **5. Pricing Sources**

As a result of the introduction of the euro, certain existing pricing sources for national currency markets of the participating countries may cease to exist and be replaced by euro rates or other rates based on the euro. The definition of "LIBOR" in the MSLA, which is specified as a rate of interest applicable to default situations where Foreign Securities are involved, refers to offered rates for deposits in US Dollars. Use of the US Dollar LIBOR rate for such default situations remains consistent with current market practice in the foreign securities lending market. However, it is possible that additional euro-zone wide pricing sources, such as EURIBOR, a rate for deposits in euros sponsored by the European Banking Federation and the ACI-Financial Market Association, may become alternative rates to US Dollar LIBOR that some counterparties may wish to use in the international securities lending market.

Market participants that may have specified other pricing sources for purposes of rates or for computing the Market Value of certain types of Foreign Securities that may be re-denominated into euro should verify that their pricing source is still available after the introduction of the euro, or change their MSLA accordingly.