



Guide to Changes to the FXC Master Agreements

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I. Introduction

The publication of IFXCO by the Foreign Exchange Committee (FX Committee)¹ and other sponsoring industry groups in the United Kingdom, Canada, and Japan is the result of a project undertaken by the Financial Markets Lawyers Group (FMLG).² In 2003, the FMLG commenced a study to determine whether the existing master agreements published by the FX Committee (individually, the International Foreign Exchange Master Agreement (IFEMA), the International Currency Options Market Master Agreement (ICOM Master Agreement), and the International Foreign Exchange and Options Master Agreement (FEOMA), and collectively, the “FXC Master Agreements”) should be updated in light of developments since their last publication in 1997.

One such development occurred in 1999, when in response to several disruptions in the foreign exchange markets (notably in Asia), the FX Committee published new force majeure provisions that could be adopted by parties as an amendment or supplement to the FXC Master Agreements. Another occurred in 2002, when the International Swaps and Derivatives Association, Inc. (ISDA) published a new ISDA Master Agreement that included extensive revisions to the 1992 ISDA Master Agreement. Thus in 2003, the FMLG undertook a project to update the FXC Master Agreements.

At that time, the continued viability of the FXC Master Agreements came into consideration. Since the FXC Master Agreements were first published, the vast majority of master agreements involving foreign exchange and currency option transactions have been documented under the ISDA Master Agreement, a process that was accelerated by the joint publication of the 1998 FX and Currency Option Definitions by ISDA, EMTA, Inc., and the FX Committee (the “1998 Definitions”). However, a survey revealed that the FXC Master Agreements, in particular IFEMA and FEOMA, are still in use, either because they had been executed some time ago and have not been replaced, or because counterparties, such as hedge funds, that intend only to enter into foreign exchange transactions or currency options, or both, are using the FXC Master Agreements because they prefer a simpler master

agreement for these transactions. Accordingly, the decision was made to update the FXC Master Agreements with the objective of simplifying them for use by these counterparties.

Concurrently, the Global Documentation Steering Committee (GDSC) issued recommendations to improve all types of master agreements for derivative transactions. The GDSC considered such improvements primarily in response to the Long-Term Capital Management (LTCM) insolvency in 1998, in which differences among master agreements for different products created difficulties for market participants that desired to terminate, close out, and liquidate transactions with LTCM at that time. The GDSC has published a number of specific recommendations on its website,³ which were explicitly considered and adopted, with certain modifications, in the 2002 ISDA Master Agreement. The FMLG decided to include the GDSC recommendations, as adapted by the 2002 ISDA Master Agreement, in the update of the FXC Master Agreements.

Finally, it was noted that the 1998 Definitions had been published after the last publication of the FXC Master Agreements in 1997. It was decided that the FXC Master Agreements could be enhanced and shortened by incorporating the Definitions.

The International Foreign Exchange and Currency Option (IFXCO⁴) Master Agreement is the result of the work done by the FMLG to achieve these goals. The IFXCO Master Agreement, or IFXCO, includes: (a) updated force majeure provisions, (b) provisions recommended by the GDSC, and (c) terminology coordinated with the 1998 FX and Currency Option Definitions. In addition, certain other changes (noted below) have been made. The core provisions concerning contract execution, confirmations, payment netting, and closeout netting, however, are virtually the same as those in the other FXC Master Agreements.

Most notably, the IFXCO Master Agreement has been published in two parts—the “Terms,” which constitute the core “boilerplate” provisions, and the “Adherence Agreement,” which takes the place of the Schedule to the FXC Master Agreements and provides for the selection of variables that must be specifically agreed upon

¹The Foreign Exchange Committee is an advisory committee sponsored by, but independent of, the Federal Reserve Bank of New York. The FX Committee includes representatives of major financial institutions engaged in foreign currency trading in the United States.

²The FMLG is a key legal and policy advisory group for the Foreign Exchange Committee.

³www.newyorkfed.org/globaldoc/

⁴IFXCO is pronounced “EYE-FEX-COH.”

by the parties. The separation of the two documents is a major step to enhance ease of execution because the Adherence Agreement, a document of five pages (not including the cover page) that incorporates the Terms by reference, can be executed on a stand-alone basis. The Terms are published on the websites of the FX Committee, the FMLG, and the other sponsoring organizations.

Thus, as market participants become familiar with IFXCO, it is hoped that the simplicity of the Adherence Agreement will enhance the speed and efficiency of the negotiation process. The FMLG and the FX Committee have received opinions from counsel in more than thirty jurisdictions to the effect that this procedure is enforceable. Of course, if parties wish to attach the Terms to an Adherence Agreement, they are free to do so.

This Guide in no way constitutes part of, or should be interpreted as modifying, any contractual term contained in the IFXCO Master Agreement. Nevertheless, although IFXCO does, and is intended to, stand on its own as a legal document, the Guide provides important commentary on current market practice and IFXCO. The following sections of this Guide explain the various changes to the FXC Master Agreements represented in IFXCO. Capitalized terms used in this Summary have the meanings given to them in IFXCO, unless otherwise provided herein.

II. Changes to the FXC Master Agreements

A. Coordination with the 1998 FX and Currency Option Definitions

The 1998 Definitions use the terms “FX Transaction” and “Currency Option Transaction,” whereas the FXC Master Agreements use “FX Transaction” and “Currency Option.” IFXCO uses the terms of the 1998 Definitions.

The 1998 Definitions use the term “Settlement Date” for both FX Transactions and Currency Option Transactions, whereas the FXC Master Agreements use the traditional term “Value Date” for FX Transactions. IFXCO follows the 1998 Definitions in using the term “Settlement Date” for both.

Note that, in general, any term used in the 1998 Definitions that is not otherwise defined in IFXCO has the meaning given to it in the 1998 Definitions. Accordingly, the following terms are no longer separately defined in IFXCO, as they (or their analogs) are already defined in the 1998 Definitions: “American Style Option,” “Buyer,” “Call,” “Call Currency,” “Confirmation,” “Currency Pair,” “European Style Option,” “Exercise Date,” “Expiration Date,” “Expiration Time,” “In-the-Money Amount,” “Notice of

Exercise,” “Premium,” “Premium Payment Date,” “Put,” “Put Currency,” “Seller,” “Spot Price,” and “Strike Price.” The definition of “Business Day” has been revised to conform to that of the 1998 Definitions, although it also includes special provisions for two situations that arise under IFXCO (see Annex 1).

Furthermore, numerous provisions of the FXC Master Agreements were deemed unnecessary for IFXCO because their analogs are included in the 1998 Definitions and incorporated by reference in IFXCO. These include the provisions for payment of the Premium on a Currency Option Transaction, exercise and settlement of Currency Option Transactions, and settlement of FX Transactions.

B. Recommendations of the Global Documentation Steering Committee

As noted above, a primary objective was to update the FXC Master Agreements in light of the GDSC recommendations. These changes are outlined below.

I. Cross-Default

In a document dated November 29, 2000, the GDSC recommended a specific cross-default provision covering defaults under (a) indebtedness and (b) trading transactions. The FXC Master Agreements define the former to be “indebtedness for borrowed money,” so it does not ordinarily include trading transactions, which are usually off-balance-sheet transactions. Thus, if a party to an FXC Master Agreement defaulted in trading transactions with a third party (as opposed to the other party to the Master Agreement), there would be no default under the FXC Master Agreements. The situation is similar in the 1992 ISDA Master Agreement.

This recommendation was carefully considered in the drafting of the 2002 ISDA Master Agreement; after extensive discussions, it was not adopted. Weighing against legitimate credit concerns about a counterparty defaulting on trading transactions with third parties was the concern that such a provision might be used against a party unfairly—for example, defaults in trading transactions can occur for operational or administrative reasons and might lead to the termination and closeout of an agreement against the defaulting party by numerous counterparties, causing a liquidity crisis for the defaulter. Given the careful consideration of this issue by the ISDA drafters, it was determined that IFXCO would adopt a similar approach.



2. **Involuntary Bankruptcy Default**

Another document of the GDSC, also dated November 29, 2000, recommended that the grace period before an involuntary bankruptcy becomes an Event of Default be shortened to five (5) business days. The FXC Master Agreements already have this provision. The 2002 ISDA Master Agreement shortened its grace period for this provision from thirty (30) days to fifteen (15) days, however, because some participants were concerned that five (5) days is not enough time to achieve the dismissal of a frivolous filing. Accordingly, for the sake of consistency across master agreements, IFXCO has adopted a fifteen (15)-day grace period for its own involuntary bankruptcy Event of Default.

3. **Adequate Assurances**

In a document dated June 12, 2001, the GDSC recommended that master agreements provide for an optional adequate assurances Event of Default. The FXC Master Agreements already have this provision. IFXCO gives the parties the option of adopting this provision as an additional Event of Default in the Adherence Agreement.

4. **Force Majeure**

As noted above, a major reason for revising the FXC Master Agreements was to update its force majeure provisions. Since the publication of FEOMA in 1997, the crises in the currency markets noted above have led participants to believe that provisions in the master agreements at that time might not provide the best outcome for all parties.

The GDSC recommendation of June 12, 2001, states that there should be a uniform definition of force majeure and that force majeure should not result in a global closeout of a party's transactions following an event of default. We believe that this issue arose in response to the fact that the 1992 ISDA Master Agreement had provisions dealing with illegality but not impossibility. Impossibility is now covered in the FXC Master Agreements, the 2002 ISDA Master Agreement, and, of course, IFXCO. The FXC Master Agreements have always specified that a force majeure event is not the basis for nonperformance, while at the same time recognizing that it is not the fault of either party, restricting termination and closeout to transactions affected by the force majeure event.

The more pressing need was to update the FXC Master Agreements in light of the 1999 force majeure provisions published by the FX Committee and the subsequent learning brought about in drafting new force majeure provisions in the 2002 ISDA Master Agreement. The GDSC announced on October 29, 2003, its support of the approach that ISDA adopted in drafting its 2002 Master Agreement.

Developing an improved approach to force majeure became a question of adopting the proper balance in a grace period before transactions could be closed out. It was recognized that a thirty (30)-day grace period (which was then market standard) was too long of a grace period and that a requirement to transfer affected transactions before termination was undesirable. At the same time, it was believed that the grace period warranted for events based on illegality should differ from the grace period for events based on impossibility. For this reason, Section 7.1 of the IFXCO Terms adopts a three (3)-day grace period for illegality and an eight (8)-day grace period for impossibility, as was done for the 2002 ISDA Master Agreement. This concept appears in the definition "Waiting Period" in Section 7.1.(b) of the Terms.

Parties should also take note of Section 7.6 of the Terms. This provision is similar to a provision in the 2002 ISDA Master Agreement that states the circumstances under which the head office of a party may be expected to perform when a branch cannot perform because of a force majeure event. This provision should be read together with new Section 1.1(b) of the Terms, which specifies that the head office of a party is responsible for the obligations of its branch, subject to the exceptions provided in Section 7 relating to force majeure.

5. **Notice Provisions**

The GDSC document of August 6, 2002, recommended standard notice provisions dealing with (a) effectiveness given modern forms of communication, (b) special default certifications when the existence of an event of default depends on giving notice but notice cannot be given, and (c) changes of address. The notice provisions in Section 9.4 of the Terms have been drafted to conform to this recommendation.

6. Default Notices

This GDSC recommendation of January 24, 2003, stated that parties should endeavor to adopt standard notices to be sent to a counterparty if that counterparty is a defaulting party. The FMLG and the FX Committee support this recommendation; however, it is not a part of IFXCO itself. Recommended templates for such notices, which can be adapted for use with the FXC Master Agreements and IFXCO, are published on the GDSC website.

7. Bankruptcy Events of Default Generally

This GDSC recommendation of August 21, 2003, encouraged adoption of a “catchall” provision that covers any form of bankruptcy not already covered in the enumeration of bankruptcy/insolvency events. The definition of Insolvency Proceeding in Annex 1 of the Terms has been amended through the addition of clause (b) to include such a provision.

8. Harmonization of Time Frames

The GDSC recommended that the nondefaulting party should have the right to declare an event of default no later than one (1) local business day after notice of any nonpayment. The FXC Master Agreements already have this provision. Section 5(a) of the IFXCO Terms does as well.

C. Miscellaneous Changes

I. Terms

Given the structure of the Terms and the Adherence Agreement, some provisions from the FXC Master Agreements that were retained for IFXCO appear in different positions. The definitions have been placed in Annex 1 at the end of the Terms. With this long list of terms, which are meaningless out of context, moved to the Annex, the reader will not be distracted from the core purpose of the Terms, which is to evidence procedures for entering into, confirming, and settling FX Transactions and Currency Option Transactions, and for closing them out after default.

Similarly, the Events of Default have been listed in a section immediately before the provisions dealing with termination and closeout after default, instead of in the definitions.

A sentence has been added to Section 1.3 of the Terms to make it clear that the Parties may eliminate any MT-300 or other messages between them and rely on reports provided by

CLS Bank or any electronic trading platform as Confirmations.

Provisions dealing with certain regulatory issues that may arise under U.S. law (Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) status of parties, Employee Retirement Income Security Act of 1974 (ERISA) representations, Commodity Futures Trading Commission (CFTC) representations, and Master Agreement representations) are presented in Annex 2A of the Terms rather than in the Adherence Agreement. This permits the Adherence Agreement, in which the parties decide whether these regulatory provisions do or do not apply, to be shorter. A similar Annex 2B covers Canadian counterparties. If, in the future, regulatory issues surface for other jurisdictions, consideration will be given to whether analogous Annexes for those jurisdictions should be added.

Annex 3 of the Terms is a new provision dealing with some basic issues that arise when transactions are entered into through investment advisers or other intermediaries. The FXC Master Agreements did not have such provisions, and it is believed that their addition through the IFXCO Terms will greatly assist counterparties wishing to enter into master agreements with parties represented by such intermediaries.

2. Adherence Agreement

As noted above, the Adherence Agreement is analogous to the Schedule of the FXC Master Agreements, which allows parties to agree that the Terms shall apply to them as a master agreement and to select or vary the provisions of the Terms. The Adherence Agreement is much the same as the previous Schedule. The Adherence Agreement contains parts that allow the parties to specify scope, offices, and whether or not settlement netting shall apply.

As for other forms of netting, note that the “novation” netting provisions of the FXC Master Agreements have been eliminated from the Terms because closeout settlement netting is sufficient to accomplish the goals of parties wishing to reduce credit and settlement exposure. However, some market participants continue to receive requests from counterparties to enter into such arrangements, related to a desire not only to settle transactions on a net basis, but also to cancel (novate) transactions at the time they enter into



an offsetting transaction. For this reason, Appendix A provides standard language to accomplish this novation netting, both for FX Transactions and for Currency Option Transactions. This language, which may be added to the Adherence Agreement as Parts XV and XVI, is the same as that in the FXC Master Agreements, updated to take the 1998 Definitions into account.

Other parts in the Adherence Agreement allow the parties to specify whether the regulatory representations and local law provisions of Annexes 2A or 2B shall apply, as well as any additional covenants and (for the purposes of the cross-default Event of Default) the Threshold Amount. Unlike the FXC Master Agreements, however, the Adherence Agreement stipulates that if the parties do not specify a different Threshold Amount, that amount is deemed to be zero (\$0).

As in the case of the Schedules to the FXC Master Agreements, there are parts of the Adherence Agreement that allow the parties to specify whether or not Automatic Termination shall apply and to agree upon details for notices, payment instructions, and provisions relating to governing law and jurisdiction.

In addition, Part XI of the Adherence Agreement allows the parties to specify any Credit Support Documents that apply. Unlike the FXC Master Agreements, however, Part XI has provisions allowing the parties to agree (or stipulate) that the terms of the *1999 Collateral Annex* published by the FX Committee shall apply. These provisions are felt to be an important improvement because increasingly, transactions are collateralized in the effort to reduce credit risk.

Also notable are the provisions of the FXC Master Agreements that have not been continued under IFXCO. These include the novation netting provisions mentioned above, the provisions for discharge and termination of offsetting Currency Option Transactions, and the provision relating to nonpayment of Premiums that allows a party, upon nonpayment of a Premium for a Currency Option Transaction, to effectively “void” only that transaction without closing out all transactions under the Master Agreement. It was felt that this last provision is often negotiated out of the FXC Master Agreements; further, it does not appear in the 2002 ISDA Master Agreement. Parties may, of course, include this

as an additional provision in the Adherence Agreement.

III. Ideas for the Future

If anything is clear from the past fifteen years in the effort to adopt industry-standard master agreements, it is that the agreements must be sufficiently flexible to adapt to new situations and learning. As the market learns from court cases, changes in law, market disruptions, changes in technology, and evolving practices, it becomes desirable from time to time to adapt master agreements for the changing times. We believe that the structure of IFXCO is uniquely positioned to allow for this.

Because IFXCO is published in the form of Terms, the FX Committee can more easily publish enhancements, amendments, or supplements that take market developments into account. Such changes would be prospective in operation, so that existing Adherence Agreements would not be affected. If parties wished to incorporate a change, they could do so by exchanging a simple amendment to the Adherence Agreement.

Some of the possible supplements have already been noted—there may be particular representations or covenants that are desirable in particular jurisdictions from a regulatory point of view. Alternatively, new types of transactions may come to be recognized. A new Annex could be published to apply to the dealings in such transactions.

Thought will soon be given to whether a form of standard default notice or an update to the *1999 Collateral Annex* is desirable.

One particular question concerns what relationship IFXCO will have to changes to the 1998 Definitions. Although there have been few, if any, changes to the main body of the 1998 Definitions, there have been several updates to the rate source definitions in Annex A to the 1998 Definitions. The Terms provide that the 1998 Definitions, as amended up to the date of the Adherence Agreement, shall be incorporated into the Terms. This provision would address changes to Annex A that take place after publication of the Terms, but would preclude revisions to the 1998 Definitions from automatically governing the relationship between the parties after the date they executed the Adherence Agreement. This approach is consistent with that taken to amendments to Annex A, which are applied as of their date of publication but not retroactively to outstanding trades (unless the parties otherwise agree). It is anticipated that, if the 1998 Definitions are updated in the future in a more substantive way, the Terms will be reviewed in light of these changes. It should also be noted that Section 9.1



of the Terms allows the parties to adopt amendments to the Terms that would apply to individual transactions. Accordingly, changes to the 1998 Definitions could be applied to individual transactions by amending the relevant confirmations. (In the case of Deliverable FX Transactions that are produced by straight-through processing, the confirmation must be signed by both parties.)

Attached as Appendix B is a chart summarizing the architecture of the IFXCO documentation.

Appendix A

Suggested Novation Netting Provisions

PART XV. Novation Netting of FX Transactions

(a) *By Currency.*
 If the Parties enter into an FX Transaction through a pair of Novation Netting Offices (specified below), giving rise to a Currency Obligation for the same Settlement Date and in the same Currency as a then-existing Currency Obligation between the same pair of Novation Netting Offices, then immediately upon entering into such FX Transaction, each such Currency Obligation shall automatically and without further action be individually canceled and simultaneously replaced by a new Currency Obligation for such Settlement Date determined as follows: the amounts of such Currency that would otherwise have been deliverable by each Party on such Settlement Date shall be aggregated, and the Party with the larger aggregate amount shall have a new Currency Obligation to deliver to the other Party the amount of such Currency by which its aggregate amount exceeds the other Party's aggregate amount, provided that if the aggregate amounts are equal, no new Currency Obligation shall arise. This Part XV(a) shall not affect any other Currency Obligation of a Party to deliver any different Currency on the same Settlement Date.

Novation Netting Office(s) of Party A:

Novation Netting Office(s) of Party B:

(b) *By Matched Pair.*
 If the Parties enter into an FX Transaction between a pair of Matched Pair Novation Netting Offices (specified below) then the provisions of Part XV(a) shall apply only in respect of Currency Obligations arising by virtue of FX Transactions entered into between such pair of Matched Pair Novation Netting Offices and involving the same pair of Currencies and the same Settlement Date.

Matched Pair Novation Netting Offices of Party A:

Matched Pair Novation Netting Offices of Party B:

(c) *Inapplicability of Parts XV(a) and (b).*
 The provisions of Parts XV(a) and (b) shall not apply if a Closeout Date has occurred or a voluntary or involuntary Insolvency Proceeding or action of the kind described in Section (b), (c), or (d) of Section 5 of the Terms has occurred without being dismissed in relation to either Party.

(d) *Failure to Record.*
 The provisions of Parts XV(a) and (b) shall apply notwithstanding that either Party may fail to record the new Currency Obligation in its books.

(e) *Cutoff Date and Time.*
 The provisions of Parts XV(a) and (b) are subject to any cutoff date and cutoff time agreed upon by the applicable Novation Netting Offices and Matched Pair Novation Netting Offices of the Parties.

PART XVI. Discharge and Termination of Currency Option Transactions; Netting of Premiums

(a) *Discharge and Termination.*
 Any Call or any Put written by a Party shall automatically be discharged and terminated, in whole or in part, as applicable, against a Call or a Put, respectively, written by the other Party, such discharge and termination to occur automatically upon the payment in full of the last Premium payable in respect of such Currency Option Transactions; provided that such discharge and termination may only occur in respect of Currency Option Transactions:



- (i) each being with respect to the same Put Currency and the same Call Currency;
- (ii) each having the same Expiration Date and Expiration Time;
- (iii) each being of the same style, that is, both being American or both being European;
- (iv) each having the same Strike Price;
- (v) each being transacted by the same pair of Offices of Buyer and Seller;
- (vi) neither of which shall have been exercised by delivery of a Notice of Exercise; and
- (vii) any other fundamental features are the same (for example, both are "vanilla" or both are "barriers," both are "binaries," and so forth);

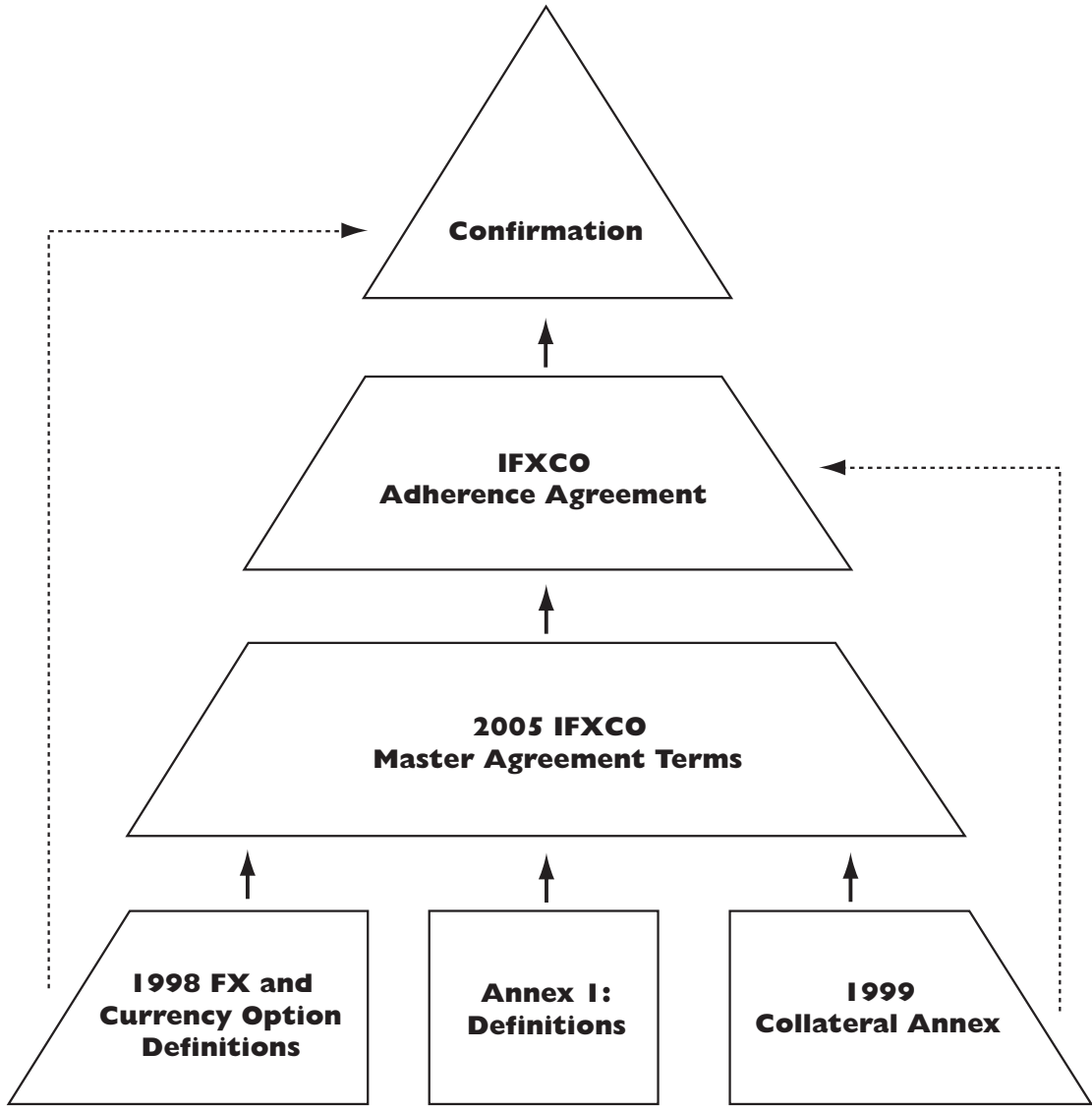
and, upon the occurrence of such discharge and termination, neither Party shall have any further obligation to the other Party in respect of the relevant Currency Option Transactions or, as the case may be, parts thereof so discharged and terminated. Such discharge and termination shall be effective notwithstanding that either Party may fail to record such discharge and termination in its books. In the case of a partial discharge and termination (that is, where the relevant Currency Option Transactions are for different amounts of the Currency Pair), the remaining portion of the Currency Option Transaction, which is partially discharged and terminated, shall continue to be a Currency Option Transaction for all purposes of the Agreement, including this Part XVI(a).

(b) *Netting of Option Premiums.*

If, on any date, Premiums would otherwise be payable under the Agreement in the same Currency between the same respective Offices of the Parties, then, on such date, each Party's obligation to make payment of any such Premium shall be automatically satisfied and discharged and, if the aggregate Premium(s) that would otherwise have been payable by such Office of one Party exceeds the aggregate Premium(s) that would otherwise have been payable by such Office of the other Party, replaced by an obligation upon the Party by whom the larger aggregate Premium(s) would have been payable to pay the other Party the excess of the larger aggregate Premium(s) over the smaller aggregate Premium(s) and, if the aggregate Premiums are equal, no payment shall be made.

Appendix B 

The Architecture of IFXCO



↑ indicates the basis or foundation for the agreements in the upper tier.