

GUIDE TO THE 1998 FX AND CURRENCY OPTION DEFINITIONS ADDENDA

Representatives of three industry groups, the International Swaps and Derivatives Association, Inc. (“ISDA”), the Emerging Markets Traders Association (“EMTA”), and the Foreign Exchange Committee (the “FXC”), have cooperated to complete the 1998 FX and Currency Option Definitions (the “Definitions”). As originally conceived, the Definitions were to deal solely with non-deliverable forward transactions in foreign exchange and the issues that arise in connection with them, such as the effect of events beyond a party’s control on its ability to settle a transaction. It became apparent at an early point, however, that the same issues would also be involved in deliverable foreign exchange transactions, especially those involving an emerging market currency. Thus the Definitions also have provisions applying to deliverable foreign exchange transactions, as well as to deliverable and non-deliverable currency option transactions.

Given the broad scope of the Definitions and the overlap with concepts such as illegality and force majeure, a working group of the Financial Markets Lawyers Group, acting on behalf of the FXC, together with representatives of the British Bankers’ Association (the “BBA”), the Canadian Foreign Exchange Committee and the Tokyo Foreign Exchange Market Practices Committee, began to work on supplements (“Addenda”) that could be included in or added to the FEOMA, the IFEMA and the ICOM Master Agreement (each a “Master Agreement”), and that would coordinate the provisions of those documents with the Definitions. The Addenda published herewith are the result of that process, and the purpose of this Guide is to explain the provisions of the Addenda. An explanation of the Definitions themselves appears in the practice notes for the Definitions. Capitalized terms used hereafter shall have the meaning given to them in the Definitions unless otherwise defined.

Note: Copies of the full 1998 FX and Currency Option Definitions may be obtained by contacting the Committee’s Executive Assistant at 212/720-6651.

As published, the Definitions contemplate that parties may make the terms of the Definitions applicable to a Transaction through a Confirmation. This is an acceptable method with respect to Currency Option Transactions under the FEOMA or the ICOM Master Agreement, which recognize the primacy of the Confirmation for a Currency Option Transaction over the Master Agreement in the event of inconsistency between the Confirmation and the Master Agreement. In contrast, the U.S. versions of the FEOMA and the IFEMA provide for the primacy of the Master Agreement over the Confirmation for an FX Transaction in the event of inconsistency between the two. (See, e.g., Section 2.4 of the U.S. versions of the FEOMA and the IFEMA; in contrast the version published by the BBA adopts the same rule for FX Transactions as for Currency Option Transactions.) Therefore, adopting a supplement to the parties' Master Agreement such as one of the Addenda would be necessary to ensure that the Definitions are effectively applied to an FX Transaction with a Confirmation including terms of the Definitions that amend the Master Agreement. In addition, it may be desirable, even in the case of Currency Option Transactions or where the BBA version of the FEOMA or the IFEMA is being used, to adopt a supplement to the parties' Master Agreement such as one of the Addenda so that the confirmation process will not be as onerous, particularly for Deliverable FX Transactions in major currencies.

Each Addendum is designed so that it can be executed as a separate supplement to the appropriate Master Agreement if the Master Agreement has already been executed. If a Master Agreement has not yet been executed, the Addendum may be integrated into the Schedule as an additional Part of the Schedule. Due to the differences in the organization of the Schedules of the different versions of the FEOMA, the IFEMA and the ICOM Master Agreement, the number of the Part that is being added to the Schedule has been left blank and should be filled in prior to execution.

There are three different Addenda—one for the FEOMA, one for the IFEMA and one for the ICOM Master Agreement. Note that in the case of the IFEMA and the ICOM Master Agreement, the earlier versions of those documents have some section numbers that differ from the 1997 versions. These differences have been noted parenthetically in those Addenda and, if used with those agreements, are the sections referenced. Alternatively, references

that do not apply in the particular case may be eliminated in the final Addendum that is executed.

There are three main points covered by each Addendum: (1) definitions and scope to establish the coverage of the Addendum and the link to the Master Agreement; (2) the relationship of the Master Agreement to Confirmations; and (3) the effect of the occurrence of a Disruption Event.

1. DEFINITIONS AND SCOPE.

Paragraph 1(a) of each Addendum makes it clear that the term "Agreement" includes the provisions of the Addendum. Paragraph 1(b) makes it clear that the use of the terminology from the Definitions in an Addendum or a Confirmation shall be deemed to refer to transactions under the Master Agreement. For example, although the term "FX Transaction" in the Definitions is also used in Master Agreements covering such Transactions, the term "Option" is used in the FEOMA and the ICOM Master Agreement for currency option transactions, whereas the Definitions use the term "Currency Option Transaction." Thus, if the Addendum appropriate for a particular Master Agreement has been executed, as a result of paragraph 1(b) practitioners can use the terminology in the Definitions in a Confirmation without conforming that terminology to that in the Master Agreement. Finally, paragraph 1(c) makes it clear that terms in the Addendum have the meanings given in the Definitions unless otherwise provided in the Addendum.

Paragraph 2(a) of the Addenda provides that the Definitions shall be deemed applicable to any FX Transaction (in the case of the FEOMA and the IFEMA) or Currency Option Transaction (in the case of the FEOMA and the ICOM Master Agreement) covered by a Master Agreement, whether or not so stated in a Confirmation. The advantage of this provision is that parties will not need to have express provisions in their Confirmations in order to have the protections offered by certain Disruption Events and Disruption Fallbacks. Under the Definitions, certain Disruption Events and Disruption Fallbacks apply to non-deliverable transactions even when the parties have made no elections of the same in the Confirmation. These Disruption Events and Fallbacks apply "by default" in the sense that they are operative although the Confirmation does not refer to them.

(See Part 3 below for further discussion of Disruption Events and Disruption Fallbacks.) In the case of Transactions where “straight-through” processing is the norm for Confirmations, this is clearly an advantage. However, if the parties do not incorporate the Definitions in a Confirmation, paragraph 2(a) of the Addendum ensures that the parties get these protections. Of course, it is still necessary for the parties to make elections in the Confirmation for a particular Transaction if they desire to modify the Disruption Events or Disruption Fallbacks that otherwise apply “by default” or to apply other “non-default” Disruption Events or Fallbacks to the Transaction.

Note that the intent of paragraph 2(a) is that the Definitions will apply to any Transactions under a Master Agreement outstanding on the date that the Addendum is executed. Thus, when an Addendum is in place there is no need to execute new Confirmations for such Transactions (as well as for new Transactions) or an amendment to get the protections afforded by the Definitions. Of course, if the parties wish to provide otherwise for any particular Transaction or group of Transactions, they should so state in the Addendum or elsewhere.

Paragraph 2(b) of the Addendum establishes the order of priority in the case of inconsistencies. The rule for a particular Transaction, including any outstanding Transaction, is that the Confirmation governs over contrary provisions in the Definitions. As for inconsistencies between the Definitions and the Master Agreement, the Definitions shall prevail. Thus the general rule is that the Confirmation has priority over the Definitions and the Master Agreement and the Definitions have priority over the Master Agreement for all Transactions (but see the next section).

2. CONFIRMATIONS.

For FX Transactions the U.S. versions of the FEOMA and the IFEMA contain an exception to the rule that the Confirmation governs in the event of inconsistencies with a Master Agreement. Paragraph 3 of the FEOMA and the IFEMA Addenda reverses this rule with respect to Non-Deliverable FX Transactions. The reason for the existing rule in the U.S. FEOMA and IFEMA is that most FX Transaction Confirmations are issued through straight-through processing. Straight-through processing means that the Confirmation is issued automatically upon entry of

trade details without any manual intervention in drafting it; an example would be Confirmations sent by SWIFT message or issued automatically and mailed on a pre-printed form. Market participants were concerned that a rule providing for primacy of the Confirmation in such cases could lead to inadvertent changes to the Master Agreement or at least to the provisions that apply to a particular FX Transaction. For example, some Confirmations are prepared with printed boilerplate that may go far beyond or conflict with what is in the FEOMA or the IFEMA.

Currency Option Transactions do not raise this level of concern because they generally are not subject to straight-through processing. Unusual or conflicting provisions in Confirmations for such Transactions are likely to be noticed and negotiated and, if accepted, not accepted inadvertently. Confirmations for Non-Deliverable FX Transactions are believed to be more like those for Currency Option Transactions. Thus, paragraph 3 of the FEOMA and IFEMA Addenda makes it clear that the terms of a Confirmation for a Non-Deliverable FX Transaction shall govern in the event of inconsistency with provisions of the Master Agreement notwithstanding any provision in the FEOMA or the IFEMA to the contrary. Furthermore, this will also be the rule for Deliverable FX Transactions under clause (ii) of paragraph 3 of the FEOMA and IFEMA Addenda if the Confirmation explicitly so states that it shall prevail and has been signed or exchanged by both parties (i.e., not just accepted because of a failure to object as provided in Section 11.15 of the U.S. FEOMA and Section 8.15 of the U.S. IFEMA). If the parties have entered into the BBA version of the FEOMA or the IFEMA, they should consider adapting the provisions in paragraph 3 of the Addenda to that version.

In sum, the usual rule of priority in the case of inconsistencies is that the Confirmation has priority over both the Definitions and the Master Agreement and the Definitions have priority over the Master Agreement. In the case of Deliverable FX Transactions that have not been confirmed under one of the special methods provided in clause (ii) of paragraph 3, however, the provision in the U.S. FEOMA and IFEMA that the Master Agreement has priority over the Confirmation is preserved because the definition of “Confirmation” in the Definitions specifies that the Confirmation must be “effective.” This is intended to include effectiveness under the rule of the particular Master Agreement as to priority of the Confirmation versus the Master Agreement for particular types of Transactions.

3. DISRUPTION EVENTS.

The Definitions provide additional flexibility and protection in the event of the occurrence of a variety of events beyond the parties' control, termed "Disruption Events" in the Definitions. The Disruption Events include disappearance of price sources needed to settle Non-Deliverable FX or Currency Option Transactions, inconvertibility and various types of exchange controls and other events that might affect a party's ability to settle. Each Disruption Event, if applicable, is linked to certain Disruption Fallbacks that are intended to provide settlement alternatives if the conditions of the relevant Disruption Event are in effect. Although some Disruption Events and Fallbacks may apply even if not specifically chosen by the parties, for some or all of their Transactions, the parties most likely will desire to negotiate and specify in the Confirmation precisely which Disruption Events and Fallbacks apply. See the Definitions practice notes for a more detailed explanation of the Disruption Events and Disruption Fallbacks.

A Disruption Event that applies to a Transaction may also be or become a force majeure event, an illegality or similar event covered by Section 9 of the FEOMA or the equivalent provisions in the IFEMA and the ICOM Master Agreement. Section 9 generally provides for a right of the party whose ability to settle is not affected by such an event to close out affected Transactions. It would not be appropriate to exercise such a right for a particular Transaction, however, if the parties had agreed that Disruption Events and Fallbacks in the Definitions should apply to the Transaction. Therefore, paragraph 4 of the Addenda (paragraph 3 in the ICOM Addendum) provides that, if a Disruption Event is applicable, Section 9 would not be applicable. This means that if the parties have specified a Disruption Event as applicable, the provi-

sions of the Definitions, including any applicable Disruption Fallbacks, will govern the parties rights and obligations instead of the close-out, transfer and other provisions of Section 9, whether or not the relevant Disruption Event has occurred.

Note that the Definitions provide that if none of the otherwise applicable Disruption Fallbacks provide the parties with a means of settlement then "No Fault Termination" under Section 5.2(f) of the Definitions shall be applicable. Thus, if the parties have specified a Disruption Event as applicable and none of the otherwise applicable Disruption Fallbacks provides a means of settlement, No Fault Termination would be applicable in lieu of the provisions in Section 9, as noted in the parenthetical in paragraph 4 of the Addenda (paragraph 3 in the ICOM Addendum).

Finally, paragraph 5 of the FEOMA and IFEMA Addenda provides that Part VI of the Schedule to the FEOMA or IFEMA is to apply. Part VI of the Schedule to each Master Agreement adds provisions adapting the close-out provisions of the Master Agreements to cash-settled (i.e., Non-Deliverable) FX Transactions. The purpose of including paragraph 5 of the FEOMA and IFEMA Addenda is to make the cash-settlement close-out provision applicable in case the parties have not done so. Presumably, parties that decide to apply the Definitions to their Transactions will be entering into Non-Deliverable FX Transactions and need the modification to the close-out provisions contained in Part VI. Parties are free to adopt alternative close-out provisions if they wish, but they should make this clear in the Addendum or elsewhere. The cash-settlement close-out provision is not included in the ICOM Addendum since it does not apply to Currency Option Transactions.

March 5, 1998

DISCLAIMER

This Guide and the related forms of documentation do not necessarily reflect the views of the Federal Reserve Bank of New York or any other component of the Federal Reserve System, or of the Foreign Exchange Committee, the Financial Markets Lawyers Group or any of their members. This Guide and such documentation do not purport to be legal advice with respect to a particular transaction or situation. If legal advice or other expert assistance is required, the services of a qualified professional should be obtained.

**Addendum dated as of _____, ____ to the
Foreign Exchange and Options Master Agreement dated as of _____, ____
(the "Master Agreement")
between _____ ("Party A") and _____ ("Party B")**

The Schedule to the Master Agreement is amended by adding the following Part ____:
Part ____ . 1998 FX and Currency Option Definitions.

The 1998 FX and Currency Option Definitions as published by ISDA, EMTA and the Foreign Exchange Committee (the "Definitions") shall be applicable to each FX Transaction and Option under the Agreement, including any FX Transaction or Option outstanding on the date hereof, subject to the following:

1. DEFINITIONS.

- (a) The term "Agreement" in Section 2.2 of the Master Agreement shall include the Master Agreement as modified and supplemented by this Part.
- (b) The terms "FX Transaction" and "Currency Option Transaction" in the Definitions or in a Confirmation shall in all cases be considered references to an "FX Transaction" and "Option," respectively, under the Agreement.
- (c) All terms in this Part shall have the meanings given them above or in the Definitions, unless not defined above or in the Definitions, in which case the term shall have the meaning given in the Master Agreement.

2. SCOPE.

- (a) Notwithstanding the absence of any reference to the Definitions in a Confirmation, this Part and the Definitions shall be applicable to any FX Transaction or Currency Option Transaction covered by the Master Agreement; provided that the Parties may agree otherwise for any Transaction as evidenced by a Confirmation that complies with Section 2.3 of the Master Agreement.
- (b) In the event of any inconsistency between the Definitions and a Confirmation, the terms of the Confirmation shall govern for the purpose of the relevant Transaction. In the event of any inconsistency between the Definitions and the Master Agreement, the Definitions shall prevail.

3. CONFIRMATIONS.

Notwithstanding Sections 2.4 and 11.12 of the Master Agreement, (i) in the event of any inconsistency between the terms of a Confirmation for a Non-Deliverable FX Transaction and the Master Agreement, the terms of the Confirmation shall prevail and (ii) in the event of any inconsistency between the terms of a Confirmation for a Deliverable FX Transaction and the Master Agreement, the terms of the Confirmation shall prevail if either the Confirmation explicitly states that it shall so prevail and has been signed by both Parties or Confirmations so stating have been exchanged as provided in Section 2.3 of the Master Agreement.

4. DISRUPTION EVENTS.

With respect to any Disruption Event that is applicable to an FX Transaction or Currency Option Transaction pursuant to the Definitions or as otherwise agreed by the Parties as evidenced by a Confirmation, Section 9 of the Master Agreement shall not be applicable in respect of such FX Transaction or Currency Option Transaction, and the Parties shall be subject to the Disruption Fallbacks (including but not limited to No Fault Termination) specified as applicable pursuant to the Definitions or such Confirmation.

5. MISCELLANEOUS.

The provisions of Part VI of the Schedule relating to cash settlement of FX Transactions shall apply to Non-Deliverable FX Transactions.

ACCEPTED AND AGREED:

PARTY A:

By _____

Name:

Title:

PARTY B:

By _____

Name:

Title:

**Addendum dated as of _____, ____ to the International
Currency Options Market Master Agreement dated as of _____, ____
(the “Master Agreement”)
between _____ (“Party A”) and _____ (“Party B”)**

The Schedule to the Master Agreement is amended by adding the following Part ____:
Part _____. 1998 FX and Currency Option Definitions.

The 1998 FX and Currency Option Definitions as published by ISDA, EMTA and the Foreign Exchange Committee (the “Definitions”) shall be applicable to each Option under the Agreement, including any Option outstanding on the date hereof, subject to the following:

1. DEFINITIONS.

- (a) The term “Agreement” in Section 2.2 of the Master Agreement shall include the Master Agreement as modified and supplemented by this Part.
- (b) The term “Currency Option Transaction” in the Definitions or in a Confirmation shall in all cases be considered references to an “Option” under the Agreement.
- (c) All terms in this Part shall have the meanings given them above or in the Definitions, unless not defined above or in the Definitions, in which case the term shall have the meaning given in the Master Agreement.

2. SCOPE.

- (a) Notwithstanding the absence of any reference to the Definitions in a Confirmation, this Part and the Definitions shall be applicable to any Currency Option Transaction covered by the Master Agreement (including outstanding Currency Option Transactions); provided that the Parties may agree otherwise for any Currency Option Transaction as evidenced by a Confirmation that complies with Section 2.3 of the Master Agreement.
- (b) In the event of any inconsistency between the Definitions and a Confirmation, the terms of the Confirmation shall govern for the purpose of the relevant Transaction. In the event of any inconsistency between the Definitions and the Master Agreement, the Definitions shall prevail.

3. DISRUPTION EVENTS.

With respect to any Disruption Event that is applicable to a Currency Option Transaction pursuant to the Definitions or as otherwise agreed by the Parties as evidenced by a Confirmation, Section 9 (Section

10 in 1992 ICOM) of the Master Agreement shall not be applicable in respect of such Currency Option Transaction, and the Parties shall be subject to the Disruption Fallbacks (including but not limited to No Fault Termination) specified as applicable pursuant to the Definitions or such Confirmation.

ACCEPTED AND AGREED:

PARTY A:

By _____
Name:
Title:

PARTY B:

By _____
Name:
Title:

**Addendum dated as of _____, ____ to the International
Foreign Exchange Master Agreement dated as of _____, ____
(the "Master Agreement")**

between _____ ("Party A") and _____ ("Party B")

The Schedule to the Master Agreement is amended by adding the following Part ____:
Part ____ 1998 FX and Currency Option Definitions.

The 1998 FX and Currency Option Definitions as published by ISDA, EMTA and the Foreign Exchange Committee (the "Definitions") shall be applicable to each FX Transaction under the Agreement, including any FX Transaction outstanding on the date hereof, subject to the following:

1. DEFINITIONS.

- (a) The term "Agreement" in Section 2.2 of the Master Agreement shall include the Master Agreement as modified and supplemented by this Part.
- (b) The term "FX Transaction" in the Definitions or in a Confirmation shall in all cases be considered references to an "FX Transaction" under the Agreement.
- (c) All terms in this Part shall have the meanings given them above or in the Definitions, unless not defined above or in the Definitions, in which case the term shall have the meaning given in the Master Agreement.

2. SCOPE.

- (a) Notwithstanding the absence of any reference to the Definitions in a Confirmation, this Part and the Definitions shall be applicable to any FX Transaction covered by the Master Agreement; provided that the Parties may agree otherwise for any FX Transaction as evidenced by a Confirmation that complies with Section 2.3 of the Master Agreement.
- (b) In the event of any inconsistency between the Definitions and a Confirmation, the terms of the Confirmation shall govern for the purpose of the relevant Transaction. In the event of any inconsistency between the Definitions and the Master Agreement, the Definitions shall prevail.

3. CONFIRMATIONS.

Notwithstanding Sections 2.4 (8.15 in 1993 IFEMA) and 8.12 (8.16 in 1993 IFEMA) of the Master Agreement, (i) in the event of any inconsistency between the terms of a Confirmation for a Non-Deliverable FX Transaction and the Master Agreement, the terms of the Confirmation shall prevail and (ii) in the event of any inconsistency between the terms of a Confirmation for a Deliverable FX Transaction and the Master Agreement, the terms of the Confirmation shall prevail if either the Confirmation explicitly states that it shall so prevail and has been signed by both Parties or Confirmations so stating have been exchanged as provided in Section 2.3 of the Master Agreement.

4. DISRUPTION EVENTS.

With respect to any Disruption Event that is applicable to an FX Transaction pursuant to the Definitions or as otherwise agreed by the Parties as evidenced by a Confirmation, Section 6 of the Master Agreement shall not be applicable in respect of such FX Transaction, and the Parties shall be subject to the Disruption Fallbacks (including but not limited to No Fault Termination) specified as applicable pursuant to the Definitions or such Confirmation.

5. MISCELLANEOUS.

The provisions of Part VI of the Schedule relating to cash settlement of FX Transactions (no equivalent provision in 1993 IFEMA) shall apply to Non-Deliverable FX Transactions.

ACCEPTED AND AGREED:

PARTY A:

By _____
Name:
Title:

PARTY B:

By _____
Name:
Title: