

Client Alert

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Derivatives and Structured Products Group

New 2013 FBF Master Agreement

On 25 June 2013, the French Banking Federation (*Fédération Bancaire Française* or the “**FBF**”) updated its Master Agreement on forward financial instruments (the “**FBF Master Agreement**”). This version is the fourth version of the FBF Master Agreement (the “**2013 FBF Master Agreement**”)¹.

One of the stated aims of this update is to address new regulatory requirements imposed by Regulation (EU) No. 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories (together with the nine regulatory and implementing technical standards adopted on 19 December 2012 by the European Commission to complement the obligations defined thereunder, “**EMIR**”). At the same time, the 2013 FBF Master Agreement incorporates various amendments aimed in particular at introducing greater flexibility with respect to the determination of the Settlement Amount and clarifying certain provisions of the FBF Master Agreement.

The 2013 FBF Master Agreement is published in French, together with an English translation, and includes a proposed standard schedule (the “**Standard Schedule**”) allowing the parties to make various elections to supplement, or as an alternative to, the new provisions of the 2013 FBF Master Agreement.

In order to assist parties who have executed earlier versions of the FBF Master Agreement, the FBF has also published:

- a standard amendment agreement to update an existing 2007 version of the FBF Master Agreement with the new provisions contained in the 2013 FBF Master Agreement (including provisions dealing with EMIR requirements); and
- three 'stand-alone' EMIR Addenda for parties to incorporate applicable EMIR requirements only into existing 1994, 2001 and 2007 versions of the FBF Master Agreement.

Unless otherwise defined herein, capitalized terms used in this note shall have the same meaning as ascribed to them in the 2013 FBF Master Agreement. Unless otherwise noted, references to **Articles** are references to the articles of the 2013 FBF Master Agreement.

¹ The first version was published by the FBF in 1994, followed by the second version in 2001 and the third in 2007.



Gide Loyrette Nouel

Algiers

Tel. +213 (0)21 23 94 94
gln.algiers@gide.com

Beijing

Tel. +86 10 6597 4511
gln.beijing@gide.com

Brussels

Tel. +32 (0)2 231 11 40
gln.brussels@gide.com

Bucharest

Tel. +40 21 223 03 10
gln.bucharest@gide.com

Budapest

Tel. +36 1 411 74 00
gln.budapest@gide.com

Casablanca

Tel. +212 (0)5 22 27 46 28
gln.casablanca@gide.com

Hanoi

Tel. +84 4 3946 2350
gln.hanoi@gide.com

Ho Chi Minh City

Tel. +84 8 3823 8599
gln.hcmc@gide.com

Hong Kong

Tel. +852 2536 9110
gln.hongkong@gide.com

Istanbul

Tel. +90 212 385 04 00
gln.istanbul@gide.com

Kyiv

Tel. +380 44 206 0980
gln.kyiv@gide.com

London

Tel. +44 (0)20 7382 5500
gln.london@gide.com

Moscow

Tel. +7 495 258 31 00
gln.moscow@gide.com

New York

Tel. +1 212 403 6700
gln.newyork@gide.com

Paris

Tel. +33 (0)1 40 75 60 00
info@gide.com

Saint Petersburg

Tel. +7 812 303 6900
gln.saintpetersburg@gide.com

Shanghai

Tel. +86 21 5306 8899
gln.shanghai@gide.com

Tunis

Tel. +216 71 891 993
tunis@gln-a.com

Warsaw

Tel. +48 22 344 00 00
gln.warsaw@gide.com



EMIR Requirements

Timely Confirmation

The timely confirmation requirements imposed by EMIR are addressed in the 2013 FBF Master Agreement by requiring that any Confirmation in relation to a Transaction be made in the form and within the deadlines imposed by EMIR or any applicable regulation (**Article 4.2**).

Article 1 of the Standard Schedule also offers the parties an option to elect for “deemed consent” to the terms of a proposed Confirmation if, after two Business Days from the initial receipt of a Confirmation by a relevant party, such party has not expressly raised any objections (subject to manifest error).

Representation of Regulatory Clearing Status

In order to address the potentially differing EMIR requirements applicable to parties, depending on their status, the 2013 FBF Master Agreement introduces a new representation regarding the “Regulatory Clearing Status” under EMIR or other applicable regulation imposing a clearing obligation for one or more Transactions. A list of such clearing statuses is set out in Article 7 of the Standard Schedule (e.g. financial counterparty (as defined in Article 2(8) of EMIR), non-financial counterparty (as defined in Article 2(9) of EMIR) or exempted counterparty).

Such representation is made at the time of entering into the 2013 FBF Master Agreement and repeated each time a Transaction is executed. Furthermore, each party is obliged to, without delay, inform the other of any change to its “Regulatory Clearing Status” and the reasons for such change (**Article 6.2**).

A misrepresentation or failure to comply with its obligations under **Article 6.2** will not constitute an Event of Default (i.e. will not give rise to a termination right), but may trigger the contractual liability (*responsabilité contractuelle*) of the relevant party. However, if a breach of **Article 6.2** results in a failure to comply with a clearing obligation, then this will trigger a Change of Circumstances under **Articles 7.2.1.3** and **7.2.2.3**, giving rise to a right to terminate (as further described below).

EMIR Risk Management

EMIR requirements relating to risk management are dealt with in the 2013 FBF Master Agreement by imposing on the parties an obligation to co-operate in complying with all applicable laws and regulations, in particular with respect to: (i) reporting of Transactions, (ii) formalisation of procedures and arrangements to measure, monitor and mitigate operational and credit risk, (iii) mark-to-market on a daily basis of the value of outstanding Transactions, and (iv) implementation of risk management procedures that require timely, accurate and appropriately segregated exchanges of collateral (**Articles 11.9 to 11.12**).

A breach of such obligations will not constitute an Event of Default under the 2013 FBF Master Agreement, but may trigger the contractual liability of the relevant party.

Clearing by a central counterparty

The 2013 FBF Master Agreement addresses only EMIR requirements for OTC derivatives transactions not cleared by a central counterparty². However, it does provide for a more general obligation on the parties to use their best efforts, including executing or amending any necessary agreements, to allow a central counterparty to clear a Transaction, within the deadlines imposed by applicable regulations, as soon as a Transaction becomes clearable pursuant to any legal or regulatory obligation, or to any agreement between the parties (**Article 11.13**).

The 2013 FBF Master Agreement also adds a new “Change of Circumstances” (i.e. an additional termination event) where Transaction(s), which are subject to a clearing obligation by applicable regulations, are not cleared within the deadlines imposed thereunder (**Article 7.2.1.3**). Only those Transaction(s) affected by the failure can be terminated. The party entitled to terminate the Transaction(s) will depend on the cause of the failure (**Article 7.2.2.3**), namely:

- the Non-Affected Party, if failure to clear is caused by one of the parties failing to comply with its notifications obligations under **Article 6.2** (Regulatory Clearing Status), such party being the sole Affected Party; or
- either party, if the failure to clear is caused by any other reason, with both parties being Affected Parties in this case.

Calculation of Settlement Amount - Flexibility Introduced

Amended Definition of “Replacement Value”

Drawing lessons from the financial crises, the 2013 FBF Master Agreement amends the definition of Replacement Value to provide greater flexibility in determining the amount that parties are required to pay to each other upon an early termination of some or all Transactions under the 2013 FBF Master Agreement. The Replacement Value is no longer automatically the arithmetic mean of the market quotations from at least two prime market participants (and if no market quotations can be obtained, the gains or costs of the calculating party), but now corresponds to the gains or losses incurred by the party responsible for the calculation (i.e. the Non-Defaulting Party or the Non-Affected Party, or if there are two Affected Parties, each Affected Party), with such calculating party afforded a discretion to calculate its gains or losses on the basis of:

- market quotations from at least two prime market participants (unlike the previous versions, the 2013 FBF Master Agreement explicitly states that the market quotations are chosen by the calculating party); and/or
- market data available via databases supplied by at least two third parties and commonly used by market participants to establish their own quotations or valuations.

² The FBF intends to publish a separate document dealing with Transactions cleared by central counterparty towards the end of 2013.



If no market quotations or market data are available the party responsible for the calculation may use internal sources to determine the Replacement Value, as long as these sources are commonly used by such party to value similar transactions.

Finally, if not already reflected in the market quotations or market data used, the calculating party may also take into account any losses, costs or gains incurred in order to terminate or hedge one or more terminated Transactions.

This updated definition of Replacement Value is similar in several respects to the “Close-out Amount” mechanism under the 2002 version of the Master Agreement published by the International Swaps and Derivatives Association (“ISDA”) (although certain factors of the 2002 ISDA Master Agreement, such as the creditworthiness of the counterparty, are not taken into account in the determination of the Replacement Value), whereas the definition of Replacement Value in earlier versions of the FBF Master Agreement could be said to be more similar to the “Market Quotation” method, with “Loss” as a fallback, as set out under the 1992 ISDA Master Agreement.

Introduction of Liquidity Costs & Liquidity Gains

The 2013 FBF Master Agreement introduces the concept of Liquidity Cost and Liquidity Gain (as each are defined in **Article 3**) to enable the party responsible for calculating the Settlement Amount to include the gains and costs of transactions entered into to hedge the cash position generated by a termination of one or more Transactions into the calculation of such Settlement Amount (**Article 8**).

Such amount of Liquidity Costs or Liquidity Gains will be added to the amount of Replacement Value and Amounts Due when calculating the Settlement Amount, but only to the extent not already included in the calculation of the Replacement Value (as described above).

Clarifications

No Hierarchy between Events of Default

Even if such principle was not previously explicitly expressed in the FBF Master Agreement, the general understanding by many market participants is that there is no hierarchy among the different Events of Default (i.e. in a default scenario where more than one Event of Default has been triggered, the Non-Defaulting Party is free to invoke whichever Event of Default it wishes as the cause of a termination). This market presumption has now been expressly confirmed in the 2013 FBF Master Agreement (**Article 1 (iii)**).

The hierarchy between a Change of Circumstances and an Event of Default is unchanged in the 2013 FBF Master Agreement, meaning that if a Change of Circumstances directly results in the occurrence of an Event of Default, such Event of Default is deemed not to have occurred (**Article 7.2.2.4**).

It may also be worth noting that, unlike under the ISDA Master Agreement, the “continuance” of an Event of

Default is not a prerequisite for the Non-Defaulting Party to terminate under the FBF Master Agreement (the mere occurrence of the Event of Default being sufficient, unless waived expressly or by performance) (**Article 7.1.2**).

Assignment to a Third Party

The 2013 FBF Master Agreement now explicitly states that each party may transfer, assign or grant as a security interest or as a guarantee all or part of its claim corresponding to the Settlement Amount calculated following the termination of a Transaction without the prior written consent of the other party (**Article 11.4**).

Miscellaneous

Scope of the 2013 FBF Master Agreement

The definition of “Transaction” has been amended to update references to the articles of the French *Code monétaire et financier* (“CMF”) defining forward financial instruments (i.e. Articles L.211-1-III and D.211-1 A of the CMF), but also to slightly broaden the scope of the FBF Master Agreement by including any other forward financial instruments not listed in Article L.211-1-III of the CMF, but which benefit from the French favourable netting regime (Article L.211-36 II of the CMF).

Business Day

The definition of “Business Day” has been expanded to address in more detail the different contexts in which the defined term is used, introducing slightly different definitions in relation to payment obligations, Delivery obligations, the Change of Circumstances under **Article 7.2.1.1** and a general catch-all definition. Similarly defined terms are used in the 2002 ISDA Master Agreement for “Local Delivery Day” and “General Business Day”.

Payment netting

Previously subject to an election by the parties in the schedule to the FBF Master Agreement, payment netting for reciprocal payments or deliveries taking place on the same day in respect of the same Transaction is now applicable by default under the 2013 FBF Master Agreement. However, “multiple transactions” payment netting (i.e. payment netting for reciprocal payments and deliveries occurring on the same day under several Transactions) remains subject to the election of the parties in Article 2 of the Standard Schedule (**Article 5.2**).

No Agency and Non-Reliance Representations

The capacity and authority representation has been broadened to add a “no agency” representation (**Article 6.1.2**). In addition, the non-reliance representation (**Article 6.1.9**) has been expanded based on current regulations, case law and market conventions. As a result of such revised representation, each party has the sole responsibility for determining the suitability of any contemplated Transactions, it being understood that each such party has the necessary competence (either internally or through independent professional



advice) to make such determination. Moreover, it is acknowledged that no information exchanged between the parties in relation to the Transactions shall be deemed to constitute investment advice or recommendation.

Failure to Pay or Deliver – Grace Periods

The grace period applicable following a failure to pay or Deliver under a Transaction has been reduced to one Business Day (from three Business Days previously), aligning it with the grace period applicable to the “Failure to Pay or Deliver” Event of Default under the 2002 ISDA Master Agreement (**Article 7.1.1.1**).

Default under a security interest or guarantee

The 2013 FBF Master Agreement extends the Event of Default relating to security interest or guarantees granted in favour of the Non-Defaulting Party (previously only covering events capable of resulting in any such security interest or guarantee becoming void, unenforceable or ceasing to exist) to capture any failure to comply with, or any breach of, a representation or an obligation under the relevant security interest or guarantee, rendering this Event of Default closer to the “Credit Support Default” Event of Default under ISDA Master Agreements (**Article 7.1.1.8**).

Notices

Article 8 of the Standard Schedule suggests that parties amend **Article 11.1** to provide that notices relating to the exercise of a right under a Transaction may be given by telephone, unless otherwise stipulated in the Confirmation relating thereto.



Contacts

For further information, please contact the following member(s) of the Derivatives and Structured Products Group:

Karine Imbrosciano (London & Paris)

Partner
imbrosciano@gide.com
Tel. +44 (0)20 7382 5543

Phung Pham (London)

Partner
ppham@gide.com
Tel. +44 (0)20 7382 5596

*With the participation of
Claire-Marine Costa-De Jonckheere and Sarah Whitley*

Gide Loyrette Nouel LLP

125 Old Broad Street
London EC2N 1AR
Tel. +44 (0)20 7382 5500
Fax +44 (0)20 7382 5501

For further information:

www.gide.com



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