User's Guide to the ISDA Credit Support Documents under English Law

ISDA®

INTERNATIONAL SWAPS AND DERIVATIVES ASSOCIATION, INC.

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THIS USER'S GUIDE DOES NOT PURPORT, AND SHOULD NOT BE CONSIDERED, TO BE A GUIDE TO OR EXPLANATION OF ALL RELEVANT ISSUES AND CONSIDERATIONS THAT MAY BE RELEVANT TO A PARTICULAR CREDIT SUPPORT ARRANGEMENT, INCLUDING RELEVANT ENFORCEABILITY, REGULATORY, TAX, ACCOUNTING AND OTHER ASPECTS. EACH PARTY SHOULD THEREFORE CONSULT WITH ITS LEGAL AND TAX ADVISERS AND ANY OTHER ADVISER IT DEEMS APPROPRIATE PRIOR TO USING ANY ISDA STANDARD DOCUMENTATION. ISDA ASSUMES NO RESPONSIBILITY FOR ANY USE TO WHICH ANY OF ITS DOCUMENTATION OR ANY DEFINITION OR PROVISION CONTAINED IN ITS DOCUMENTATION MAY BE PUT.

Without prejudice to the foregoing, to the extent that this Guide refers to statutory or case law, the reference is to the law as at 15 March 1999.

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USER'S GUIDE TO
THE ISDA CREDIT SUPPORT DOCUMENTS UNDER ENGLISH LAW

I. GENERAL

A. Background and Overview

In 1994 the International Swaps and Derivatives Association, Inc. ("ISDA") published the 1994 ISDA Credit Support Annex under New York law (the "New York CSA") for use in documenting bilateral security and other credit support arrangements between counterparties for transactions governed by an ISDA Master Agreement that selects New York law as the governing law.[1]

In 1995 ISDA published two additional standard form credit support documents for use in documenting bilateral security and other credit support arrangements under English law between counterparties for transactions governed by an ISDA Master Agreement.[2] These documents are:

(1) the ISDA Credit Support Deed (Bilateral Form - Security Interest) (the "Deed"); and

(2) the ISDA Credit Support Annex (Bilateral Form - Transfer) (the "Annex").

In 1996 ISDA published the 1996 ISDA Credit Support Annex under Japanese law (the "Japanese CSA") for use in documenting bilateral and other credit support arrangements under Japanese law between counterparties for transactions governed by an ISDA Master Agreement. A User's Guide has also been published for the Japanese CSA.

This User's Guide is designed to explain the Deed and the Annex and to highlight the principal differences between each of those documents. (An additional section comparing each of these documents to the New York CSA has also been included for the benefit of those already familiar with the New York CSA.)

In this Guide, in keeping with commercial usage, the term "collateral" is used to refer to assets transferred by one party to the other from time to time under the Deed or the Annex. Normally these assets will be readily marketable securities and/or cash. In relation to the Annex, the use of the term "collateral" in this Guide is without prejudice to the fact that the Annex is not intended to create a charge or other security interest under English law over the assets transferred under its terms.

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1 Parties interested in using the New York CSA are referred to the User's Guide to the 1994 ISDA Credit Support Annex published by ISDA.

2 The Deed and the Annex may each be used with either of the ISDA Master Agreements published by ISDA in 1992, namely, the 1992 ISDA Master Agreement (Multicurrency - Cross Border) and the 1992 ISDA Master Agreement (Local Currency - Single Jurisdiction). Although it is technically possible to use the Deed or the Annex with the 1987 Interest Rate and Currency Exchange Agreement (the "1987 Agreement"), a number of significant amendments to the 1987 Agreement need to be made. Parties wishing to use the Deed or the Annex where a 1987 Agreement is in place with a counterparty may find it easier to upgrade the 1987 Agreement to the 1992 ISDA Master Agreement (Multicurrency - Cross Border) using the form of Amendment Agreement in Appendix B to the User's Guide to the 1992 ISDA Master Agreements (1993 edition).

A capitalised term used without definition in this Guide is intended to have the meaning given that term in the Deed, the Annex or the ISDA Master Agreement, depending upon the context in which it is used in this Guide.

Where parties wish to use the Deed or the Annex with an ISDA Master Agreement subject to New York law, they are advised to consult their legal advisers. Parties might also wish to bear in mind the general considerations as to governing law raised in *B.12* below in relation to the Deed and in *C.9* below in relation to the Annex, but should consult their legal advisers for specific advice in any particular case.

The Deed is a stand-alone security agreement, relying for its effectiveness principally upon the creation of a security interest in collateral transferred under it. It is a Credit Support Document under the ISDA Master Agreement to which it relates.

The Annex is an annex to the ISDA Master Agreement, relying for its effectiveness principally upon the netting provisions of the ISDA Master Agreement. As noted above, it is not intended to create a security interest under English law in the collateral transferred under the Annex. Instead, the value of the collateral transferred to (and not yet returned by) a party prior to the default of the other party becomes an element in the close-out calculation under Section 6(e) of the ISDA Master Agreement. The party providing the collateral retains no proprietary interest in the collateral itself, the intention being that full legal and beneficial ownership in the collateral passes under the Annex to the collateral taker.

As in the case of the New York CSA, each of the English law forms is bilateral. Either party may be required to provide or entitled to receive collateral. The collateral requirements under each form are determined in relation to the net exposure under the ISDA Master Agreement on a mark-to-market basis, subject to any applicable threshold, minimum transfer amount or other relevant condition specified in the final Paragraph (Elections and Variables) of the form. These conditions are described further below in relation to each form.

As each form secures the net exposure under the ISDA Master Agreement, each party should be confident that close-out netting works in all relevant jurisdictions. Which jurisdictions are relevant is a matter of judgement for each party, but bank regulatory authorities generally consider that the relevant jurisdictions are the jurisdiction of the governing law of the ISDA Master Agreement (typically, New York or England), the jurisdiction of the governing law of each Transaction under the ISDA Master Agreement (this will normally be the same as that of the ISDA Master Agreement, but could be different in the case of any Transaction(s) governed by the ISDA Master Agreement pursuant to a "sweep-in" clause[3]), the jurisdiction of organisation of each party and, in the case of a multibranch party, the jurisdiction of the location of each branch.

ISDA has obtained opinions on the effectiveness of netting in a number of jurisdictions (over thirty as at the date of publication of this Guide). Each party should satisfy itself, however, as a matter of prudence that the intended netting will be effective against its counterparty. Where it seeks to rely on an opinion obtained by ISDA for this purpose, it should be sure that the opinion is reasonably up-to-date and that its counterparty is of a type and the transactions to be entered into are each of a type falling within the

3 A "sweep-in" clause is a clause is a clause under which transactions originally entered into outside the ISDA Master Agreement are deemed to be governed by the ISDA Master Agreement for purposes of the early termination and close-out netting provisions. A limited example of such a clause is the ISDA BBAIRS/FRABBA Bridge, but more widely drafted "sweep-in" clauses are sometimes included in Part 5 of the Schedule to the ISDA Master Agreement. Such a clause requires careful drafting to ensure that it is clear, certain and effective.

scope of the opinion. Certain types of entities, for example, insurance companies, are not covered by many of the ISDA netting opinions.

ISDA has also obtained opinions on the enforceability of the Deed, the Annex and the New York CSA from a number of jurisdictions, and is currently in the process of obtaining opinions from a number of other jurisdictions. As in the case of the netting opinions, a party seeking to rely on a collateral opinion should ensure that its counterparty is of a type and the transactions to be entered into are each of a type falling within the scope of the opinion. In some cases for certain types of collateral arrangement with certain types of counterparty and/or relating to certain types of collateral assets, there are additional actions to be taken or formalities to be complied with to ensure the effectiveness of the arrangement. (Such actions or formalities are sometimes referred to as "perfection" requirements and are discussed in more detail below.) Opinions should be reviewed carefully in this regard, and local counsel should be consulted where necessary.

Parties considering entering into a collateral arrangement should consider which of the two English law forms is appropriate according to the circumstances of each case. In the remainder of *Part I* of this Guide, parties considering use of one of the English law forms will find general guidance on the circumstances in which each form might be appropriate. In *Part II* of this Guide, parties will find more detailed guidance on the completion of the final Paragraph of each form, Paragraph 13 in the case of the Deed and Paragraph 11 in the case of the Annex. The final Paragraph of each form is analogous to the Schedule to an ISDA Master Agreement. It permits the parties to customise the credit support document according to their agreed objectives. It is important that it be completed clearly and that all necessary elections be made.

In *Part III* of this Guide, guidance is given on general tax considerations that might arise when using either form, with particular reference to UK taxation by way of illustration. In *Parts IV and V* of this Guide, a brief comparison of each English law form to each other is given and, for those who are familiar with the New York CSA, a brief comparison of each form to the New York CSA is also given. This is to provide some help to institutions seeking to develop, to the extent possible, uniform practices and procedures in relation to collateral management in each regional centre. Finally, various Appendices have been included to assist parties in understanding and using each of' the forms.

ISDA's programme of work in relation to collateral arrangements is not confined to the publication of its standard form credit support documents and related User's Guides and the obtaining of collateral opinions. For some time a working group of collateral practitioners has been meeting on a regular basis, primarily in New York and London, to discuss market practice, agree standards, exchange information and promote greater harmonisation and efficiency in relation to collateral management. In November 1998, ISDA published its Guidelines for Collateral Practitioners, which summarised the conclusions reached by the working group over the prior two years.

Since most of that work was completed before the market events of the latter half of 1998 and because collateral management practice continues to evolve with the markets, the working group has continued to meet with the intention of publishing further recommendations and to refine and update its prior guidelines. In March 1999, the ISDA 1999 Collateral Review was published. The Collateral Review sets forth a number of recommendations for market participants, ISDA and regulators to consider in order to minimize the effects of market volatility on collateral positions. ISDA will be working with regulators

and legislators to press for reform and harmonisation of national laws relating to the creation, maintenance and enforcement of collateral arrangements.

Further information on all of ISDA's current activities in relation to collateral arrangements, along with information regarding its various other publications and activities, may be obtained from the ISDA website at ***www.isda.org.***

B. The Deed: Structure, Form and Key Provisions

1. Structure and Form. The Deed was prepared as a stand-alone security document and not as an annex to the ISDA Master Agreement to which it relates. This is because it is considered advantageous under English law for certain formal reasons for it to be executed as a deed. One such reason is mentioned in *10* below in relation to Paragraph 8(b) of the Deed. There is no particular benefit under English law in annexing a security document to the principal document to which it relates, therefore no advantage has been lost by preparing it as a separate document. *Appendix D* of this Guide sets out the usual requirements, as at the date of publication of this Guide, for the execution of a deed under English law. A party's constitutional documents and local law in its place of organisation may also be relevant.

The Deed constitutes a Credit Support Document for purposes of the related ISDA Master Agreement. In the event of any inconsistency between the Deed and the ISDA Master Agreement, the Deed will prevail. In the event of any inconsistency between Paragraph 13 (Elections and Variations) and the other provisions of the Deed, Paragraph 13 will prevail.

As noted above, the Deed is a bilateral form in that it contemplates that each party may be required to post Eligible Credit Support to the other. In most circumstances, a party will be acting in one capacity only at any particular time, as Chargor or as Secured Party. It is possible, however, that in certain circumstances a party might be the Chargor in relation to Posted Collateral held by the other party as Secured Party, while itself holding Posted Collateral as Secured Party received from the other party as Chargor. It should be clear as a matter of fact in each case in which capacity, and in relation to which assets as Posted Collateral, each party is acting at any time.

2. Covenant to Perform. As is customary in an English law security document, the Deed includes in Paragraph 2(a) a covenant by each party to perform the Obligations undertaken in the related ISDA Master Agreement, the Deed or any other "relevant agreement" (determined by reference to the scope of the definition of "Obligations", which may be amended by the parties in Paragraph 13(b) of the Deed). The purpose of this covenant is principally to provide a clear point from which the limitation period for any claim under the Deed begins to run. As a result of including this covenant, the limitation period runs from the date demand is made for payment under the Deed. The limitation period is the period within which an action arising out of the Deed must be brought.[4] This covenant also brings the incidental benefit that it extends the limitation period to 12 years. This is because the covenant makes the Deed a specialty (that is, an obligation contained in a document under seal). Section 8(1) of the UK Limitation Act 1980 extends the limitation period for an action arising from a specialty from 6 years (the usual for contractual debt claims) to the above-mentioned 12 years.

4 Generally speaking, in England and Wales it is not necessary to bring proceedings in order to exercise the rights of enforcement given by the Deed. This may not be true, however, in relation to collateral located in certain other jurisdictions.

The covenant also helps to ensure that Obligations, other than those under the related ISDA Master Agreement, if any, are properly secured by the Deed. Note that the term "Obligations" may be expanded in Paragraph 13(b) to include obligations of a third party, such as an Affiliate of the Chargor, although in such a case other issues (such as whether there is a commercial benefit to the Chargor in giving such security) may need to be considered.

3. Types of Credit Support. The Deed contemplates two basic types of credit support. For purposes of eligibility for transfer to the Secured Party, these are referred to in the Deed as Eligible Collateral and Other Eligible Support. When held by the Secured Party, these are referred to in the Deed as Posted Collateral and Other Posted Support.

a. ***Eligible Collateral; Posted Collateral; Assigned Rights.*** Posted Collateral consists of assets of the Chargor transferred to the Secured Party subject to the security interest granted by the Chargor in Paragraph 2(b) of the Deed. The parties specify in Paragraph 13 of the Deed what assets will constitute Eligible Collateral for this purpose. Although there is no limit in theory on what assets the parties might choose to specify, in practice they will typically specify readily marketable securities and/or cash in one or more freely transferable currencies.

In relation to securities, current market practice suggests that parties will most commonly specify government securities as Eligible Collateral, but they might also specify corporate debt securities, including securities issued by emerging market issuers, and/or equity securities. In relation to such securities, additional provisions may be necessary or appropriate. For example, in relation to securities issued by emerging market issuers, additional provisions may be necessary to deal with liquidity problems, special settlement procedures, political risk and/or any other matter that might be relevant to the particular securities contemplated. In relation to equity securities, additional provisions may be necessary dealing with adjustments and extraordinary events affecting the securities. Stamp duty may be payable and the provisions of Section 4(e) of the ISDA Master Agreement will be relevant. Although Paragraph 6 (Holding Posted Collateral) includes provisions dealing with calls, voting rights and similar matters, these may need to be reconsidered in particular cases.

In relation to cash, the Deed grants to the Secured Party a security interest in cash "to the fullest extent permitted by law". This is because until recently there was some doubt under English law, following the case *Re Charge Card Services Limited*,[5] as to whether or not it was possible for a chargor to create a security interest in a cash deposit in favour of the party holding that deposit. In the *Charge Card* case, the High Court's reasoning was that the charge taken over the deposit is in fact taken over the debt created by the deposit. Since the court reasoned that it is "conceptually impossible" for the holder of a deposit to take a charge over a debt it owed, the attempted charge back to the depositor would be ineffective. In order to avoid the *Charge Card* problem, cash collateral under the Deed was often deposited with a third party bank and then assigned by way of security to the Secured Party. In such a case, the Secured Party had a security interest in a debt owed by a third party rather than itself.

5 [1986] 3 All ER 289.

In 1996 in *Re Bank of Credit and Commerce International SA (No. 8),*[6] the House of Lords overruled the *Charge Card* case. It is therefore now clear as a matter of English law that a depositor of cash may charge its deposit back to the deposit-taker, as contemplated in the case of the Deed by Paragraph 2(b)(ii).

The obligation of the Secured Party to repay the cash is subject not only to this security interest but also to the contractual set-off provision in Paragraph 8(a)(ii)(B) of the Deed. To the extent, therefore, that the security interest failed for any reason, the Secured Party should be able to rely on this contractual set-off, provided that it would be effective against the Chargor in the event of the Chargor's insolvency.

Parties should note that the provisions in Paragraph 6 of the Deed contemplate the use by the Secured Party of a Custodian to hold Posted Collateral. It is important that the Custodian be notified of the ownership interest of the Chargor in Posted Collateral held by the Custodian and, to perfect the security interest, that the Custodian also be notified of the security interest in favour of the Secured Party. Parties may wish to deal with these issues and any other obligations of the Custodian in a separate agreement with the Custodian. Normally the Secured Party will want to ensure that the Custodian waives, to the fullest extent possible, any prior right it might otherwise have against the Posted Collateral.

To reinforce the security obtained by the Secured Party in relation to Posted Collateral, the Chargor also assigns the "Assigned Rights" to the Secured Party under sub-clause (iii) of Paragraph 2(b). The Assigned Rights are any rights relating to Posted Collateral against a clearance system, financial intermediary or other third party holding or transferring the Posted Collateral at any time.

When a Chargor holds securities in fungible form in a book-entry clearing system, difficult issues may arise as to the nature of the asset over which the Chargor is granting a security interest. The characterisation of this asset may affect the perfection and priority of a security interest in the asset. To a large extent the issues raised by clearing systems turn on the nature of the securities, the structure and rules of the clearing system, the laws of the jurisdiction in which the system is located and the documentation governing the relations between the operator and participants in the system. Often the laws of other jurisdictions are also relevant, particularly where the securities are held in physical form for the account of the global custodian by a sub-custodian in another jurisdiction.

Similarly, difficult issues are sometimes raised where securities are held through a chain of custodians. At each link in the chain, the proprietary interest of the original owner of the securities (and therefore of any grantee of a security interest by that owner) may be affected by the contractual relationship between the two custodians forming that link, by the manner in which either custodian holds the securities for the benefit of its customers, by the laws in which either custodian is located and by various other factors.

A detailed consideration of the issues raised by clearing systems and custodians is beyond the scope of this Guide, but considerable work has been done on such issues in a number of

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6 [1997] 4 All ER 568 HL sub nom *Morris v Agrichemicals Ltd.*

countries in recent years, particularly in relation to the larger clearing systems. Some of this work has led to legislation on these issues in a few jurisdictions, for example, the introduction in many states of the USA, including New York in 1997, of revised Article 8 of the US Uniform Commercial Code.

Article 9(2) of the European Union Settlement Finality Directive also deals with these issues. Member states of the European Union are required to implement the Directive, including Article 9(2), by 11 December 1999.[7]

The legal and technical literature on these issues continues to grow, and much of it is very helpful. Parties should seek appropriate professional advice in any case of uncertainty.

b. ***Other Eligible Support; Other Posted Support.*** Under the Deed, the Chargor is also permitted to deliver certain other types of credit support, for example, a letter of credit, a financial guarantee or a surety bond. These would not constitute security in the sense referred to in *a* above (that is, would not be subject to the security interest), but should, of course, be taken into account for determining the amount of collateral on hand on any Valuation Date.

4. Other Provisions Relating to Security. Paragraph 2(c) of the Deed provides for the release of the security interest granted under Paragraph 2(b) in relation to any Posted Collateral transferred back to the Chargor. This clause also makes it clear, in relation to fungible securities, that the Secured Party is not obliged to return the identical securities it originally received, which would generally not be possible. It is merely required to return equivalent fungible securities.

The remainder of Paragraph 2 of the Deed includes various provisions customarily included in an English law security document relating to securities or cash. The general effect of these is to strengthen the security interest granted under Paragraph 2(b).

5. Credit Support Obligations. Paragraph 3 of the Deed sets out the mechanics for determining when a party as Chargor is required to deliver collateral to the other party as Secured Party, and under what circumstances it is entitled to the return of some or all of that collateral. The general principle is that such collateral calls and returns are determined on specified Valuation Dates (daily, weekly, monthly or as otherwise agreed) on a mark-to-market basis. This is described in detail below in relation to Paragraph 13 (Elections and Variables). Paragraph 13 is designed to provide considerable scope for customising the basic mark-to-market mechanics of Paragraph 3 to the particular requirements of each counterparty relationship.

6. Conditions Precedent, Transfers, Calculations and Substitutions. Paragraph 4(a) of the Deed specifies conditions precedent to the transfer obligations of each party comparable to those in Section 2(a)(iii) of the ISDA Master Agreement.

Paragraph 4(b) specifies in principle how transfers will be made under the Deed in relation to cash, certificated securities and book-entry securities. It also provides in effect that each transfer of Eligible Collateral (a) in the form of cash will be made on the next Local Business Day and (b) in the form of securities will be made on the number of days after demand (adjusted if the demand is made after the

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[7] Directive 98/26/EC of the European Parliament and of the Council of 19 May 1998 on settlement finality in payment and securities settlement systems, OJ L 166, 11.6.98, p. 45.

specified Notification Time) customary for settlement through the agreed clearance system or otherwise in the relevant local market. This provision is intended to be sufficiently flexible to accommodate different settlement periods for different types of securities and in different international and European domestic markets and settlement systems.

Paragraph 4(c) provides that calculations of exposure and the value of collateral will be made by the relevant Valuation Agent specified in Paragraph 13 (Elections and Variables), and that the Valuation Agent shall notify its calculations to the other party (or to both parties, if it is not itself a party) by the Notification Time on the Local Business Day after the relevant Valuation Date.

Paragraph 4(d) deals with substitutions of collateral. All substitutions require the consent of the Secured Party in order to minimise the risk that the Deed might constitute a floating charge as a matter of English law. Parties are advised to consult their legal advisers as to whether or not, even with the consent of the Secured Party, a risk remains that the Deed constitutes a floating charge. Parties are also advised to consult their legal advisers as to the consequences of the Deed constituting a floating charge, which may include a requirement, in certain circumstances, to register the Deed with the UK Registrar of Companies in accordance with the UK Companies Act 1985 (see also *Part IV.B.4* of this Guide).

If registration is required, then failure to register the Deed within the relevant time period will result in (i) the Deed being void against a liquidator, administrator or other creditor of the Chargor and (ii) the debt secured by the Deed becoming immediately payable. (Although it is not clear whether this latter provision would compel early termination of outstanding Transactions, this appears to be a risk.) In addition, when registration is required and the Deed is not registered within the relevant time period, the Chargor is rendered liable to a fine and, for continued contravention, to a daily default fine. The registration requirement, if applicable, applies not only to UK counterparties but also to overseas counterparties that have an established place of business in England and Wales in respect of charges over property in England and Wales.

It is also important to note that under English insolvency law a floating charge would have a lower ranking than a fixed charge and would rank behind certain statutorily preferred creditors and expenses of administration or liquidation. A floating charge is also subject to special avoidance provisions under the UK Insolvency Act 1986.

7. Dispute Resolution. If a party disputes the Valuation Agent's determination of exposure or valuation of collateral on hand, Paragraph 5 provides a framework for resolving the dispute if the dispute cannot be resolved informally. Since disputes will relate to an element of the Valuation Agent's calculation of the delivery or return amount of collateral due (if any) in respect of a Valuation Date, Paragraph 5 provides that (i) the undisputed amount (if any) is to be transferred and (ii) the parties will consult to resolve the dispute as to the remainder.

If the dispute relates to determination of the exposure, the Valuation Agent will recalculate the exposure on the basis of market quotations. If it relates to valuation of collateral, the Valuation Agent will value the collateral using the method specified in Paragraph 13. As there is no fallback specified in the Deed, the parties must remember to specify an agreed method for valuing collateral in Paragraph 13.

Following the recalculation as outlined above, the disputed amount is to be transferred. Paragraph 5(b) (Not a Relevant Event) provides a saving clause to ensure that failure to deliver a disputed amount does not constitute a Relevant Event under Paragraph 7 (Default).

8. Holding Posted Collateral. Paragraph 6 includes a number of important provisions in relation to the holding of collateral by the Secured Party or on its behalf by its Custodian:

a. ***Care of Posted Collateral.*** Paragraph 6(a) provides that the Secured Party will exercise reasonable care in relation to collateral it holds to the extent required by applicable law, but otherwise disclaims any duty of the Secured Party in relation to matters such as rights or other entitlements relating to securities it holds as collateral.

b. ***Eligibility to Hold Posted Collateral; Custodians.*** Paragraph 6(b) permits the parties to specify in Paragraph 13 any conditions that will be imposed on a Secured Party before it is entitled to hold directly, or to appoint a Custodian to hold, collateral. This is intended to give the parties the flexibility to build in some control over how and by whom collateral is held. The Secured Party accepts liability for acts or omissions of its Custodian.

c. ***Segregated Accounts.*** To provide an additional safeguard in relation to all non-cash collateral held by the Secured Party or its Custodian, such collateral is required to be held in a segregated account. This also provides some protection to the Secured Party as it helps to ensure that the Chargor's proprietary interest (its equity of redemption) in the securities, upon which the Secured Party's continuing security interest depends, is not lost through commingling with the property of the Secured Party.

In relation to cash collateral, segregation was thought not to be necessary as the charge is over the Secured Party's contractual obligation to repay cash in the relevant amount and not over any cash held by the Secured Party *in specie*.

d. ***No Use of Collateral.*** The Deed includes, in Paragraph 6(d), a complete prohibition on any sale, loan, rehypothecation or other use or disposition by the Secured Party of collateral held under the Deed. This is because any such use or disposition would risk extinguishing the security interest created by the Deed in such collateral.

e. ***Rights Accompanying Posted Collateral.*** The Chargor is entitled under Paragraph 6(e) to any distributions made to holders of securities that the Chargor has posted as collateral and may require the Secured Party to exercise voting rights, where those attach to Posted Collateral in the form of securities. In relation to the latter, however, it must reimburse the Secured Party for any expense incurred as a result. After the occurrence of a default, the Secured Party has certain additional rights to exercise voting rights or other rights or powers attaching to Posted Collateral in the form of securities.

f. ***Calls and Other Obligations.*** The Chargor is responsible for all calls on Posted Collateral in the form of securities and must reimburse the Secured Party where it, in its discretion, decides to pay the call. The Chargor must also supply information to the Secured Party where this may be required of a holder of the securities, for example, under section 212 of the UK Companies Act 1985 (under which a public company may require, subject to certain conditions, disclosure of a

person's holdings of interests in the company). Paragraph 6(f) includes a general disclaimer of the Secured Party's liability to perform any obligation, make any payment or take any other action in relation to Posted Collateral in the form of securities.

g. ***Distributions and Interest Amount.*** The Secured Party will pass through to the Chargor any distributions of assets or rights it receives in relation to Posted Collateral in the form of securities and will pay interest compounded daily on any cash collateral held at the rate specified by the parties in Paragraph 13 (which may be zero, if the parties do not want to provide for interest).

9. Default. Paragraph 7 sets out the events that give rise to the Secured Party's enforcement rights under the Deed, namely, the occurrence of any Event of Default under the related ISDA Master Agreement and failure to perform any obligation under the Deed. In relation to defaults under the Deed, there is a cure period of (a) two Local Business Days after notice in relation to a failure to transfer collateral or related distributions or interest and (b) 30 days after notice in relation to any other obligation under the Deed.

Although the term "Relevant Event" is defined in relation to both parties and therefore could apply in relation to the Secured Party, no specific consequences are specified in the Deed upon the occurrence of a Relevant Event in relation to the Secured Party. The parties may, however, wish to include a provision in Paragraph 13 specifying the consequences of such an occurrence.

10. Rights of Enforcement. The most important part of the Deed is Paragraph 8, which sets out the enforcement rights of the Secured Party. The Secured Party's enforcement rights arise upon the occurrence of a Relevant Event or Specified Condition in relation to the Chargor, as well as the occurrence or designation of an Early Termination Date with respect to the Chargor. The Secured Party may, therefore, exercise its rights under Paragraph 8 prior to the occurrence or designation of an Early Termination Date, although this will perhaps not be common in practice.

Paragraph 8(a) (Secured Party's Rights) sets out the principal enforcement rights and powers of the Secured Party. Paragraph 8(a)(i) deals with Posted Collateral other than cash, while Paragraph 8(a)(ii) deals with cash collateral.

Paragraph 8(a)(i) excludes the application of sections 93 and 103 of the UK Law of Property Act 1925. Each of these sections restricts the exercise of certain rights by a secured creditor but may be disapplied by agreement between the parties. Paragraph 8(a)(i) confers on the Secured Party the power to sell Posted Collateral to satisfy the secured Obligations and to receive monies otherwise due to th Chargor in relation to the Posted Collateral.

Paragraph 8(a)(ii) grants the Secured Party both the power to apply cash collateral to discharge the secured Obligations and also, as discussed in *3.a* above, the power to exercise a contractual right of set-off against the cash collateral it is holding and would otherwise be obliged to return (subject to other conditions in the Deed) to the Chargor.

Paragraph 8(b) (Power of Attorney) grants the Secured Party a power of attorney solely for the purpose of securing the performance of the Obligations. Under this power of attorney the Secured Party may execute documents, exercise rights and take other actions that would otherwise have to be executed,

exercised or taken directly by the Chargor in order to protect and/or realise the rights of the Secured Party under the Deed.

Note that in order for the Secured Party to execute a document as a deed under this power of attorney, the power of attorney must itself be granted pursuant to a deed. This is one of the reasons, referred to in *1* above, why it is recommended that the Deed be executed as a deed, observing the formalities appropriate for each party. These formalities will depend to a large extent upon where the party is organised. The constitutional documents and local law in the place of organisation of the party may also be relevant.

Paragraph 8(c) (Protection of Purchaser) provides certain standard protections for a purchaser of collateral assets from the Secured Party. These protections also indirectly protect the Secured Party by shielding it from certain potential liabilities to the purchaser that might otherwise arise.

Paragraphs 8(d) (Deficiencies and Excess Proceeds) and 8(e) (Final Returns) provide, as would be expected, that: (i) if the collateral realised under the Deed is insufficient to satisfy the secured obligations, the Chargor remains liable for the deficiency; (ii) if the collateral realised under the Deed exceeds the secured obligations, the balance is to be returned to the Chargor (without prejudice to any further set-off or counterclaim that may be available to the Secured Party); and (iii) if the Chargor has no further present or future Obligations (which may be defined to be limited to obligations under the related Master Agreement or may be expanded in Paragraph 13(b) (Security Interest for "Obligations") of the Deed), the Secured Party is obliged to return to the Chargor any collateral it is then still holding.

11. Representations. In Paragraph 9, each party makes standard representations, in relation to itself when acting as Chargor, as to its power to grant security, its title to collateral delivered, the validity of its security interest and the fact that its grant of security under the Deed will not give rise to any competing claims by a third party to all or any of the collateral posted under the Deed. These representations are comparable to those given in the New York CSA, except that no representation is given as to perfection or priority of any security interest created by the Deed.

In view of the greater variety of types of collateral and greater number of possible jurisdictions in which such collateral could be held contemplated by the Deed relative to the New York CSA (which contemplates only US Dollar cash and securities held in the United States), it was thought that such a representation was not practical in relation to the Deed, perfection and priority depending on a number of factors and being subject to often complex rules, including rules of private international law. Parties are therefore encouraged to consult their internal or external legal advisers, where appropriate, to satisfy themselves as to these questions, bearing in mind that, although certainty on these issues is often difficult to obtain, parties can form a view as to whether in particular circumstances any residual risk on perfection or priority is acceptably low for practical purposes.

12. Other Provisions. Paragraph 10 (Expenses) provides that each party will pay its own expenses in relation to performance of the collateral arrangements, except that the Chargor shall be liable for any taxes or similar charges, and the Defaulting Party shall pay expenses associated with realisation of the collateral.

Paragraph 11 (Other Provisions) includes a number of standard "boilerplate" provisions intended to enhance further the protection of each party in various circumstances. Paragraph 11(a) (Default

Interest) provides that the Secured Party will pay default interest compounded daily to the Chargor in relation to any overdue return of collateral or overdue payment of interest on cash collateral.

Paragraph l 1(b) (Further Assurances) is a standard covenant under which the Chargor agrees to take any action necessary to ensure the valid creation and perfection of a security interest and the Secured Party agrees to effect the release of the security interest in relation to any collateral to be returned or repaid to the Chargor under the terms of the Deed. Paragraphs 11(c) (Further Protection), 11(d) (Good Faith and Commercially Reasonable Manner), 11(e) (Demands and Notices) and 11(f) (Specifications of Certain Matters) are self-explanatory.

Paragraph 11(g) (Governing Law and Jurisdiction) provides that the governing law of the Deed is English law and further provides that the parties submit to the jurisdiction of the English courts. Given that the Deed is a separate document from the ISDA Master Agreement, it is necessary to include a separate governing law and jurisdiction clause.

There is no reason in principle, as a matter of English law, why the Deed cannot be used with an ISDA Master Agreement subject to New York law. It should be borne in mind, however, that in the event of litigation, there could be some practical inconvenience and/or additional expense entailed by having these two documents governed by different governing laws.

If the parties wish to avoid the possible inconvenience or expense mentioned above, they should consider either having English law apply to their ISDA Master Agreement or, otherwise, entering into the New York CSA. It would not be advisable, however, to change the governing law of the Deed to New York law. There are important substantive differences between English law and New York law in relation to the taking of security. The Deed has been drafted only with English law principles in mind. Clearly, other factors may also be relevant (and, perhaps, ultimately more important) to the decision whether or not to enter into the Deed or the New York CSA. See *Part V* of this Guide, which summarises the principal differences between the Deed and the New York CSA.

Paragraph 12 includes a number of important definitions. The key definitions are discussed above in this Guide in relation to the Paragraph of the Deed in which they appear and/or below in relation to the completion of Paragraph 13 (Elections and Variations) of the Deed.

Paragraph 13 is reviewed in some detail in *Part II.A* of this Guide, particularly in relation to practical considerations to bear in mind when completing Paragraph 13.

Where parties are entering into a Deed in relation to a pre-existing ISDA Master Agreement and intend to collateralise pre-existing Transactions, they should be aware that the Deed could be held, in certain circumstances, to be a preference under applicable insolvency law. In general terms, where an insolvent company enters into a transaction (for example, the granting of a charge such as that contemplated by the Deed) within a relevant suspect period (usually six months in the case of English insolvency law, but two years for certain connected persons) prior to the commencement of formal insolvency proceedings which has the effect of improving the creditor's position relative to other creditors, then the transaction (or, in this case, the Deed) may be void or voidable as a preference.

The precise terms of the preference doctrine vary from country to country, but providing security for pre-existing obligations normally gives rise to a preference risk. In some countries, such as England, a

transaction is preferential only if the insolvent company intentionally preferred the relevant creditor over other creditors. In other countries, the intention of the insolvent company in entering into the transaction is not relevant.

C. The Annex: Structure, Form and Key Provisions

1. Structure and Form. Unlike the Deed, which is a stand-alone document, the Annex, like the New York CSA, is to be used as an annex to the ISDA Master Agreement to which it relates. There is no particular need for this structure under English insolvency law, but it has a number of advantages. The principal advantage is that the drafting of the Annex is considerably streamlined relative to the Deed. For example, it is not necessary to have separate provisions dealing with conditions precedent, default events, notices or governing law, as these are all covered by the ISDA Master Agreement. Also, the Annex relies for its effectiveness on the close-out netting provisions of Section 6(e) of the ISDA Master Agreement. The integration of the Annex into the ISDA Master Agreement serves to underline this point.

Because the Annex forms part of the ISDA Master Agreement, it is not strictly necessary to specify that it is a Credit Support Document in relation to the ISDA Master Agreement. If the parties wish to do so in order that sub-clause (3) of Section 5(a)(iii) of the ISDA Master Agreement applies to the Annex, they may do so by inserting a provision to that effect in Paragraph 11(h) (Other Provisions) of the Annex.

In the event of any inconsistency between the Annex and the rest of the Schedule to the related ISDA Master Agreement, the Annex will prevail. In the event of any inconsistency between Paragraph 11 (Elections and Variables) and the other provisions of the Annex, Paragraph 11 will prevail.

Like the Deed and the New York CSA, the Annex is a bilateral form in that it contemplates that each party may be required to transfer Eligible Credit Support to the other. In most circumstances, a party will be acting in one capacity only at any particular time, as Transferor or as Transferee. It is possible, however, that in certain relatively rare circumstances a party might be the Transferor in relation to a Credit Support Balance in relation for which the other party is Transferee, while itself the Transferee for a Credit Support Balance in relation to which the other party is Transferor. It should be clear as a matter of fact in each case in which capacity, and in relation to which Credit Support Balance, each party is acting at any time.

2. Types of Credit Support. Unlike the Deed, the Annex contemplates only the transfer by the Transferor of cash and securities as Eligible Credit Support. It does not provide for Other Eligible Support as that term is used in the Deed. If the parties wish to take into account Other Eligible Support, appropriate provisions to that effect may be included in Paragraph 11(h). This does, however, require careful drafting.

Eligible Credit Support consists of cash and/or securities transferred by the Transferor outright to the Transferee in accordance with Paragraph 5(a) (Transfer of Title). The parties specify in Paragraph 11(b)(ii) (Eligible Credit Support) the types of asset that will constitute Eligible Credit Support for this purpose.

In relation to securities, current market practice suggests that parties will most commonly specify government securities as Eligible Credit Support, but they might also specify corporate debt securities,

including securities issued by emerging market issuers, and/or equity securities. As noted in relation to the Deed (see *B.3.a* above), when including such securities additional provisions may be necessary or appropriate.

It is important for the effectiveness of the outright transfer contemplated by the Annex, however, that the securities used are capable of being traded. Parties are, therefore, advised to consult their legal advisers if considering the use under the Annex of emerging market debt or equity securities or other securities possibly subject to trading restrictions.

3. Credit Support Obligations. Paragraph 2 of the Annex sets out the general mechanics determining when a party as Transferor is required to transfer collateral to the other party as Transferee, and under what circumstances it is entitled to the return of some or all of that collateral. The general principle is that such collateral calls and returns are determined on specified Valuation Dates (daily, weekly, monthly or as otherwise agreed) on a mark-to-market basis. This is described in detail below in relation to Paragraph 11 (Elections and Variables). Paragraph 11 is designed to provide considerable scope for customising the basic mark-to-market mechanics of Paragraph 2 to the particular requirements of each counterparty relationship.

4. Transfers, Calculations and Exchanges. Paragraph 3(a) (Transfers) specifies how transfers will be made under the Annex in relation to cash, certificated securities and book-entry securities. It also provides in effect that each transfer of Eligible Collateral (a) in the form of cash will be made on the next Local Business Day and (b) in the form of securities will be made on the number of days after demand (adjusted, if the demand is made after the specified Notification Time) customary for settlement through the agreed clearance system or otherwise in the relevant local market. This provision is intended to be sufficiently flexible to accommodate different settlement periods for different types of securities and in clifferent international and European domestic markets and settlement systems.

Paragraph 3(b) (Calculations) provides that calculations of exposure and the value of collateral will be made by the relevant Valuation Agent, specified in Paragraph 11 (Elections and Variables), and that the Valuation Agent shall notify its calculations to the other party (or to both parties, if it is not itself a party) by the Notification Time on the Local Business Day after the relevant Valuation Date.

Paragraph 3(c) (Exchanges) deals with exchanges of collateral. All exchanges require the consent of the Transferee.

5. Dispute Resolution. If a party disputes the Valuation Agent's determination of exposure or valuation of collateral on hand, Paragraph 4 provides a framework for resolving the dispute if the dispute cannot be resolved informally. Since disputes will relate to an element of the Valuation Agent's calculation of the delivery or return amount of collateral due (if any) in respect of a Valuation Date, Paragraph 4 provides that (a) the undisputed amount (if any) is to be transferred and (b) the parties will consult to resolve the dispute as to the remainder.

If the dispute relates to determination of the exposure, the Valuation Agent will recalculate the exposure on the basis of market quotations. If it relates to valuation of collateral, the Valuation Agent will value the collateral using the method specified in Paragraph 11. The parties must remember to specify such a method in Paragraph 11, as there is no fallback method specified in the Annex.

Following the recalculation as outlined above, the disputed amount is to be transferred. Paragraph 4(b) (No Event of Default) provides a saving clause to ensure that failure to deliver a disputed amount does not constitute an Event of Default under the ISDA Master Agreement of which the Annex forms part.

6. Distributions and Interest Amount. Paragraph 5(c) provides that the Transferee will pass through to the Transferor any distributions of assets or rights it receives in relation to transferred securities and will pay interest on any cash collateral at the rate (which may be zero if the parties do not want to provide for interest), and in accordance with the method, specified in Paragraph 11.

7. Default. The most important part of the Annex is Paragraph 6, which provides that, upon the designation or deemed occurrence of an Early Termination Date as a result of an Event of Default, an amount equal to the value of the Credit Support Balance at that time will be included, as an Unpaid Amount, within the close-out netting contemplated by Section 6(e) of the ISDA Master Agreement. This is not a separate and subsequent contractual set-off of the net exposure under the ISDA Master Agreement against the value of collateral. Instead, the cash value on default of the Transferee's conditional contractual obligation to make a payment in relation to cash collateral or to deliver equivalent fungible securities in relation to securities collateral (in other words, the cash value on default of the Credit Support Balance) forms an integral part of the final close-out of Transactions under the single agreement created by the ISDA Master Agreement.

It should be noted that Paragraph 6 provides that the Credit Support Balance will be valued, for purposes of close-out, on the same basis as it would on any other Valuation Date. This means, in relation to securities collateral, that a "haircut" will typically be applied to securities collateral by valuing those securities at the specified Valuation Percentage for each relevant type of security (see, further, *Part II.A.3* of this Guide regarding Valuation Percentages). Most parties, however, will want the value of securities comprised in the Credit Support Balance to be valued at full market value on default and therefore should amend Paragraph 6 to provide for this. This may be done in more than one way, but one suggested approach would be to amend the definition of "Valuation Percentage" in Paragraph 10 of the Annex by adding at the end of that definition the words ", except that, for the purposes of Paragraph 6, Valuation Percentage for each item of Eligible Credit Support is 100%."

It should also be noted that Paragraph 6 only applies in relation to an Event of Default as Termination Events are not generally considered credit events. Parties may wish to extend Paragraph 6 so that it applies upon the designation or deemed occurrence of an Early Termination Date as a result of a Termination Event in relation to all (but not less than all) Transactions. It is not strictly necessary to do this, because upon close-out of all outstanding Transactions, the exposure of each party would fall to zero, and any collateral held by one party would be required to be returned to the other party under Paragraph 2, subject, possibly, to the effect of the Minimum Transfer Amount and/or rounding provisions.

8. Representations. In Paragraph 7, each party makes standard representations in relation to itself when transferring assets under the Annex (whether providing or returning collateral) that it is the sole owner of, or otherwise has the right to transfer full ownership of, those assets to the other party under the Annex, free and clear of any interest of any third party.

9. Other Provisions. Paragraph 8 (Expenses) provides that each party will pay its own expenses in relation to performance of its obligations under the Annex, including any taxes or similar charges payable on any transfer.

Paragraph 9 (Miscellaneous) includes a number of standard "boilerplate" provisions intended to enhance further the protection of each party in various circumstances. Paragraph 9(a) (Default Interest) provides that the Transferee will pay default interest compounded daily to the Transferor in relation to any overdue return of collateral or overdue payment of interest on cash collateral. Paragraphs 9(b) (Good Faith and Commercially Reasonable Manner), 9(c) (Demands and Notices) and 9(d) (Specifications of Certain Matters) are self-explanatory.

Given that the Annex forms part of the ISDA Master Agreement to which it relates, it is *not* necessary to include a separate governing law and jurisdiction clause. Please note that if the parties wish to use the Annex with an ISDA Master Agreement subject to New York law, the practical considerations referred to in *B.12* above in relation to the Deed would also apply to the Annex. A separate governing law and jurisdiction clause *would*, in such case, be needed, unless the parties wished to have the Annex governed by New York law as well. Parties are advised, however, to consult their legal advisers for specific advice on this issue.

Paragraph 10 includes a number of important definitions. The key definitions are discussed above in this Guide in relation to the Paragraph of the Annex in which they appear and/or below in relation to the completion of Paragraph 11 of the Annex.

Paragraph 11 is reviewed in some detail in *Part II.C* of this Guide, particularly in relation to practical considerations to bear in mind when completing Paragraph 11.

Where an ISDA Master Agreement is already in place between the parties, they may wish to enter into an amendment agreement incorporating the Annex into the ISDA Master Agreement. *Appendix A* sets out an example of such an agreement. Where parties intend to take collateral under the Annex for pre-existing Transactions, they should take into account the risk that this could be held to be a preference under applicable insolvency law. This issue is discussed in *B.12* above in relation to the Deed.

D. Collateralised and Non-collateralised Transactions

Strictly speaking, it is not possible to include collateralised and non-collateralised Transactions under the same ISDA Master Agreement. The reason is simple. Upon default, as a result of Section 6(c)(ii) of the ISDA Master Agreement, no further amount is due in relation to individual Transactions under the Agreement. Instead, an amount is due under Section 6(e), the close-out provision. The close-out amount is determined on a net basis by reference to all Terminated Transactions, and there is no clear method for determining which "part" of that net amount may be allocated to the collateralised Transactions and which "part" may be allocated to the non-collateralised Transactions. This should come as no surprise, as it is a natural consequence of the single agreement created by the ISDA Master Agreement.

It is possible, however, by careful drafting to create an economic effect similar to collateralisation of some but not all Transactions under the same ISDA Master Agreement. There is more than one way to achieve this, but one possibility would be for the term "Exposure" in the Deed or Annex, as the case may

be, to be amended to refer only to "Collateralised Transactions", so that the Credit Support Amount represents only the net exposure of the Secured Party in relation to those Transactions specified as Collateralised Transactions. Thus, the Chargor is never required to deliver more collateral than it would have done if such Transactions had genuinely been separately collateralised. Nevertheless, upon the early termination of all Transactions as a result of an Event of Default under the Master Agreement, all of the collateral on hand would be available to satisfy the total amount payable on early termination up to the full value of that collateral.

It is important that the "Collateralised Transactions" are clearly specified, but this may be done in a number of ways. The parties may, for example, define "Collateralised Transaction" to mean each Transaction identified as such in the related Confirmation, or each Transaction of a specified product type. Note that the former approach may be more difficult to achieve operationally, but the latter approach may lead to ambiguity in relation to hybrid or exotic transactions that do not clearly fall within a single product type.

For the reasons mentioned above, it is not recommended that the definition of "Obligations" be amended to achieve the inclusion of collateralised and non-collateralised Transactions under the same ISDA Master Agreement. The advantage of the drafting approach recommended above is that it does not undermine the single agreement nature of the ISDA Master Agreement, since the amount of collateral on hand is available to secure the amount due under Section 6(e), the close-out provision, but subject to a cap equal to the net mark-to-market value as of the latest Valuation Date of the "Collateralised Transactions" only.

II. COMPLETING THE ELECTIONS AND VARIABLES PARAGRAPH

Each of' the Deed and the Annex reflects certain basic assumptions upon which the collateral arrangements are based. As discussed above, such assumptions may be varied by the parties in the relevant final Paragraph (Elections and Variables) of each form, namely, Paragraph 13 of the Deed and Paragraph l 1 of the Annex. For example, both the Deed and the Annex assume that the collateral required will be an amount equal to the current net mark-to-market value of all Transactions under the ISDA Master Agreement less the value of collateral on hand. This assumption, as described below, can be varied, among other ways, by (1) using Independent Amounts, Thresholds and Minimum Transfer Amounts and/or (2) modifying the definition of Credit Support Amount to adjust the basis on which the amount of risk to be covered is determined.

The final Paragraph of each of the Deed and the Annex permits the parties to customize the document to suit their particular circumstances by providing in a convenient form for various elections and possible modifications.

While it is certainly not necessary for parties to make every possible modification contemplated by the relevant final Paragraph, parties should be aware that each final Paragraph includes certain provisions that must be completed if the relevant form is properly to take effect. In other words, there are certain provisions for which no fallback has been specified in the form. For example, there is no fallback provision indicating what constitutes Eligible Collateral and no fallback provision indicating which days count as Valuation Dates. If either of these provisions has not been properly completed, then the parties have not created an effective collateral arrangement using the relevant form. Parties should note that, as an alternative, any election or variation may be made or specified in one or more Confirmations or other documents (see Paragraph 11(f) of the Deed and Paragraph 9(d) of the Annex).

The Guide attempts to highlight below provisions for which there is no fallback in the relevant form. Parties are advised, however, to satisfy themselves that they have accurately and fully completed the relevant final Paragraph with all terms essential to their own collateral arrangement.

To assist in the completion of the Elections and Variables Paragraph of each form, set out below is a discussion of each sub-paragraph of Paragraph 13 and Paragraph 11, as applicable. Confirmations may be used to effect either general amendments to the relevant ISDA Master Agreement or Transaction-specific amendments. Parties desiring to use Confirmations to effect general amendments should make that intent clear in their Confirmations so as to avoid any implication that such changes will cease to apply once the Transaction covered by the Confirmation matures or is terminated. Before effecting any general amendment to an ISDA Master Agreement through the use of a Confirmation, parties should consider whether this approach could pose operational difficulties.

At the end of the discussion of each subparagraph of each Elections and Variables Paragraph, there is a list of cross-references that identifies the Paragraphs of the form that relate to or specifically cite the subparagraph discussed. After the detailed discussion of each Elections and Variables Paragraph, there is a summary of the completion of that Paragraph, intended for use as a checklist to assist the parties in appropriately completing the Paragraph.

A. The Deed: Paragraph 13. Elections and Variables

1. Paragraph 13(a): Base Currency and Eligible Currency. The "Base Currency" is defined as United States Dollars, unless the parties specify otherwise. The Base Currency is the common currency into which all values are converted for purposes of determining the adjusted aggregate exposure of the Secured Party and the adjusted aggregate value of collateral on hand. Parties should therefore select the currency most convenient for purposes of collateral management.

"Eligible Currency" is defined as each of the Base Currency and any other freely available currency agreed and specified by the parties in this subparagraph. The term is used for purposes of defining each currency in which cash collateral may be denominated in Paragraph 13(c)(ii)(A).

Cross-references: Paragraph 12 (definitions of "Base Currency", "Base Currency Equivalent" and "Eligible Currency").

2. Paragraph 13(b): Security Interest for "Obligations". "Obligations" is the term used in the Deed to describe those obligations that are to be secured or otherwise supported by Posted Credit Support in relation to each party. The term is defined in Paragraph 12 as "all present and future obligations of that party under the [ISDA Master] Agreement and this [Credit Support] Deed and any additional obligations specified for that party in Paragraph 13(b)".

Paragraph 13(b) can, therefore, be used to modify the definition of "Obligations", for example, to cover obligations arising under other agreements between the parties. Parties need to consult their legal advisers, however, as to whether such "cross-collateralisation" would be enforceable against the Chargor under the insolvency law of its country of incorporation.

Cross-references: Paragraphs 2, 7, 8 and 12 (definition of "Obligations").

3. Paragraph 13(c)(i): Delivery Amount, Return Amount, Credit Support Amount.

a. ***Delivery Amount.*** The Delivery Amount is, in essence, the amount of additional (or "top-up") collateral due as determined on any Valuation Date. It is defined in Paragraph 3(a) more precisely to mean, as of any Valuation Date, the amount by which the Credit Support Amount (in essence, the adjusted exposure) exceeds the Value of all Posted Credit Support (in essence, the collateral on hand) held by the Secured Party, as adjusted to reflect prior collateral movements (either way) that have not yet fully settled.

If the Delivery Amount exceeds the Minimum Transfer Amount (if any) applicable to the Chargor, then the Chargor will transfer Eligible Credit Support having a Value as of the date of transfer at least equal to the Delivery Amount, rounded as specified in Paragraph 13(c)(iii)(D). In other words, the Delivery Amount is first compared to the Minimum Transfer Amount. If it does not exceed the Minimum Transfer Amount, then no transfer is due in respect of that Valuation Date. If it does exceed the Minimum Transfer Amount, then the Delivery Amount is rounded and the rounded amount is transferred.

Note that it is possible, in certain circumstances, that a Delivery Amount exceeds the Minimum Transfer Amount, but as a result of the agreed rounding convention, the rounded amount

to be transferred is zero. Note also that there is no fallback Minimum Transfer Amount and no fallback rounding convention.

Parties may modify the definition of "Delivery Amount" in Paragraph 13(c)(i)(A) to adjust the method of calculating the amount of Eligible Credit Support that the Chargor must deliver to the Secured Party. In general, if a change is made to "Delivery Amount", a corresponding change should be made to "Return Amount".

Cross-references: Paragraphs 3(a), 5 and 6(g).

b. ***Return Amount.*** The Return Amount is, in essence, the amount of excess collateral that may be drawn down by the Chargor as determined on any Valuation Date. It is defined in Paragraph 3(b) more precisely to mean, as of any Valuation Date, the amount by which the Value of all Posted Credit Support (in essence, the collateral on hand) held by the Secured Party exceeds the Credit Support Amount (in essence, the adjusted exposure), as adjusted to reflect prior collateral movements (either way) that have not yet fully settled.

If the Return Amount exceeds the Minimum Transfer Amount (if any) applicable to the Secured Party, then upon demand by the Chargor the Secured Party will transfer Posted Credit Support specified by the Chargor in that demand having a Value as of the date of transfer as close as practicable to the Return Amount, rounded as specified in Paragraph 13(c)(iii)(D). In other words, the Return Amount is first compared to the Minimum Transfer Amount. If it does not exceed the Minimum Transfer Amount, then no transfer is due in respect of that Valuation Date. If it does exceed the Minimum Transfer Amount, then the Return Amount is rounded and the rounded amount is transferred.

Note that it is possible, in certain circumstances, that a Return Amount exceeds the Minimum Transfer Amount, but as a result of the agreed rounding convention, the rounded amount to be transferred is zero. Note also that there is no fallback Minimum Transfer Amount and no fallback rounding convention.

Parties may modify the definition of "Return Amount" in Paragraph l3(c)(i)(B) to adjust the method of calculating the amount of Posted Credit Support that the Secured Party must return to the Chargor. In general, if a change is made to "Return Amount", a corresponding change should be made to "Delivery Amount".

Cross-references: Paragraphs 3(b) and 5.

c. ***Credit Support Amount.*** Unless modified by the parties, the "Credit Support Amount" is the amount of Eligible Credit Support that the Secured Party is entitled to hold as of a particular Valuation Date. In other words, it is the exposure of the Secured Party to the Chargor, adjusted to reflect agreed thresholds, minimum transfer amounts and so on.

In Paragraph 12, the "Credit Support Amount" is defined on a Valuation Date as an amount equal to:

(i) the Secured Party's Exposure; plus

(ii) all Independent Amounts applicable to the Chargor, if any; minus

(iii) all Independent Amounts applicable to the Secured Party, if any; minus

(iv) the Chargor's Threshold, if any.

The Credit Support Amount is, however, deemed to be zero whenever its calculation would yield a number less than zero. In such circumstances, it is, of course, possible that collateral should flow in the other direction.

The elements of the "Credit Support Amount" definition may be summarised as follows:

(1) **Exposure:** the net amount (as estimated by the Valuation Agent for any Valuation Date or other date on which Exposure is calculated) that one party would owe to the other party if the ISDA Master Agreement were to be terminated on a complete no-fault basis (that is, as if there were a Termination Event with two Affected Parties; market participants sometimes refer to this as "full two-way payments").

(2) **Independent Amount:** an amount used as an add-on to Exposure, reflecting, among other things, the possible increase in Exposure that may occur between Valuation Dates due to the volatility of the mark-to-market values of the secured Transactions or between a Valuation Date and the time delivery of additional Eligible Credit Support occurs. Note that the parties may express the Independent Amount as a fixed amount (per Transaction or overall) or as a formula (typically determined per Transaction, for example, as a percentage of Notional Amount). When an Independent Amount is applicable to a party, it increases the Credit Support Amount that is due by it when it is the Chargor and decreases the Credit Support Amount that is due to it when it is the Secured Party.

When parties wish to specify in connection with a particular Transaction that an Independent Amount is to be transferred at the outset of that Transaction, they would in most cases be expected to specify in the related Confirmation both (i) the relevant amount (or means by which it is to be determined) and (ii) unless already provided in Paragraph 13, that the relevant Trade Date (or other agreed date) is to be a Valuation Date for purposes of the Deed.

(3) **Threshold:** the specified amount of risk (in monetary terms) that a party is willing to tolerate without holding any Posted Credit Support provided by the other party (sometimes referred to as the "permitted unsecured risk").

If, as of a particular Valuation Date, the Credit Support Amount applicable to the Secured Party exceeds the Value as of that date of all Posted Credit Support held by the Secured Party, a Delivery Amount exists under Paragraph 3 of the Deed. Conversely, if, as of that Valuation Date, the Value of all Posted Credit Support held by the Secured Party exceeds the Credit Support Amount applicable to the Secured Party, a Return Amount exists under Paragraph 3.

Paragraph 13(c)(i)(C) enables the parties, if they wish, to substitute a different formula for determining the Credit Support Amount due in respect of each Valuation Date.

Some parties may wish to modify the method for determining the Credit Support Amount in order to eliminate the subtraction of Independent Amounts applicable to the Secured Party from the calculation of Credit Support Amount. *Appendix B* of this Guide contains suggested modifications to Paragraph 13 where this result is desired.

Note that this increases the possibility, discussed in *Part I.B.1* of this Guide, of the parties being required to act in both capacities in respect of a Valuation Date, in other words, as Chargor in relation to one amount of Posted Credit Support and Secured Party in relation to another amount. For the reasons discussed above, this should not cause any difficulty as a practical matter.

Cross-reference: Paragraph 3.

4. Paragraph 13(c)(ii): Eligible Collateral. Parties must specify the types of Eligible Collateral that a party may provide to satisfy a Delivery Amount requirement in Paragraph 13(c)(ii). There is no fallback provision, so if the relevant types of Eligible Collateral are not specified here, then the Deed will have no effect.

The parties may indicate the relevant types of Eligible Collateral by ticking the appropriate space(s) in Paragraph 13(c)(ii) in relation to each party. The identity of the relevant government issuing negotiable debt obligations of differing maturities should be completed. Additional types of Eligible Collateral may be added by specifying such collateral under the heading labelled "Other".

In relation to cash collateral, as discussed above, the relevant currencies in which cash collateral may be provided are specified under the heading "Eligible Currency" in Paragraph 13(a)(ii).

In relation to collateral in the form of securities, the parties may apply "haircuts" to the value of Eligible Collateral by specifying a "Valuation Percentage" less than 100% for particular types of Eligible Collateral. Applying a Valuation Percentage to an item of Eligible Collateral will reduce the Value attributed to that item. This is achieved by multiplying the market value of the relevant security (determined as discussed below) by the Valuation Percentage applicable to that type of security. Thus, to apply a haircut of, say, 10% to a particular security, it is necessary to specify a Valuation Percentage of 90% in relation to that type of security.

This means that the Chargor is not given full credit, for purposes of determining the Return Amount or Delivery Amount in relation to a Valuation Date, for the full value of the relevant security. In other words, in line with normal market practice for certain types of security, the security is deliberately undervalued, thereby increasing the "top-up" collateral to be delivered or decreasing the excess collateral to be returned. This extra "cushion" of value is intended, among other things, to offset a possible decrease in value in the security between Valuation Dates or between the date of a default and the enforcement of the security interest against the relevant security. More volatile or less liquid securities tend to have lower Valuation Percentages (that is, higher haircuts) than less volatile or more liquid securities, such as G7 government securities.

Parties that do not wish to discount the value of a type of Eligible Collateral should specify the Valuation Percentage to be 100% in relation to that type.

Cross-references: Paragraphs 3, 4(b), 4(d), 5, 7, 9 and 12 (definitions of "Eligible Collateral" and "Eligible Credit Support").

5. Paragraph 13(c)(iii): Other Eligible Support. In addition to Eligible Collateral, parties may specify that certain other types of credit support may be taken into account in relation to the Obligations of the Chargor. For example, a third party guarantee, letter of credit or surety bond could be specified as "Other Eligible Support" for a party. If this option is selected, the parties must also complete Paragraph 13(j) so that the "Value" of such support may be properly calculated for purposes of determining the collateral requirement under Paragraph 3, and the "Transfer of Other Eligible Support and Other Posted Support" mechanics are properly specified.

In addition, parties should carefully consider the events of default and related grace periods, if any, that should relate to a failure to comply with the requirements relating to Other Eligible Support, since for example, Paragraph 7 of the Deed and Section 5(a)(iii)(1) of the ISDA Master Agreement do not address these issues.

Cross-reference: Paragraph 12 (definitions of "Eligible Credit Support" and "Other Posted Support").

6. Paragraph 13(c)(iv): Thresholds.

a. ***Independent Amount.*** As discussed above, the "Independent Amount" in relation to a party is an amount that may be used as an add-on to Exposure to address, among other things, the volatility of a particular Transaction, the amount of time that can pass between a determination of Exposure and the delivery of Eligible Credit Support as part of a Delivery Amount and the general creditworthiness of that party. The parties may specify a single Independent Amount in relation to each party or a separate Independent Amount per Transaction. The Independent Amount(s) may be specified in relation to a party in Paragraph 13(c)(iv)(A) or in the relevant Confirmation for each Transaction. As noted above, an Independent Amount may be a specified currency amount or may be expressed as a formula (for example, as a percentage of the relevant Notional Amount or equivalent for each Transaction). If an Independent Amount is not specified, it is deemed to be zero.

Cross-references: Paragraphs 3 and 12 (definitions of "Credit Support Amount" and "Independent Amount").

b. ***Threshold.*** As discussed above, the "Threshold" is the amount of net exposure that a party as Secured Party is willing to bear in relation to the other party as Chargor before it requires the delivery of collateral under the Deed. In other words, it is the permitted unsecured credit risk a party is willing to bear in relation to the other party. A Threshold may be a specified currency amount or may be expressed as a formula (for example, as a percentage of the relevant Notional Amount). This amount is generally related to the credit quality of the other party and may be set to vary depending upon the credit rating of that party. If a Threshold is not specified, it is deemed to be zero.

Under the Deed, if as of the Valuation Time for a particular Valuation Date the Secured Party's Exposure (adjusted to reflect the agreed Independent Amounts) exceeds the Chargor's Threshold, then a Credit Support Amount exists. To the extent that this Credit Support Amount exceeds the Value of Posted Collateral then held, the Secured Party can demand that the Chargor transfer Eligible Credit Support in an amount equal to the amount of that excess, assuming it exceeds the relevant Minimum Transfer Amount (if any) and subject to the agreed rounding convention (if any), as set out in Paragraph 13.

For example, assuming at a Valuation Time on a Valuation Date that Party A has an Exposure of $3 (and no Independent Amounts have been specified) and that Party B's Threshold is $4, then Party B is not obliged to deliver any Eligible Credit Support under Paragraph 3. If, however, Party A's Exposure rises to $5 as of the Valuation Time for the next Valuation Date, then Party A can demand that Party B transfer $1 of Eligible Credit Support, that is, the amount by which Party A's Exposure ($5) exceeds Party B's Threshold ($4).

Some market participants may prefer to require the transfer of Eligible Credit Support for the *entire* amount of a party's Exposure once that party's Exposure reaches a certain amount, rather than simply the excess of the Exposure (adjusted to reflect the agreed Independent Amounts and less the Value of any Posted Credit Support) over the Threshold. This, however, requires careful drafting to achieve.

Cross-references: Paragraphs 3 and 12 (definition of "Threshold").

c. ***Minimum Transfer Amount.*** In order to avoid the need to transfer a "nuisance" amount of Eligible Credit Support as a Delivery Amount or Posted Credit Support as a Return Amount, the parties may specify a "Minimum Transfer Amount" in relation to each party. The effect of this is, as discussed above, that a Delivery Amount or Return Amount determined in relation to a Valuation Date will only be transferred if it exceeds the relevant Minimum Transfer Amount.

The precise amount set in relation to each party will depend on a number of factors, including administrative convenience and the credit quality of each party. As with the Threshold, it may be set to vary depending upon the credit rating of the relevant party. If a Minimum Transfer Amount is not specified, it is deemed to be zero.

Because the Minimum Transfer Amount only establishes a "floor", it does not eliminate the possibility that parties will be required to deliver uneven amounts as Delivery Amounts or Return Amounts. If the parties wish to ensure that only round amounts are delivered under Paragraph 3, they must establish a rounding convention, as discussed below.

Cross-references: Paragraphs 3 and 12 (definition of "Minimum Transfer Amount").

d. ***Rounding.*** As mentioned in *c* above, the parties may establish a rounding convention to avoid the need to deliver Eligible Credit Support as a Delivery Amount or Posted Credit Support as a Return Amount in an amount that is otherwise uneven or difficult to obtain in the form requested. The parties may specify a rounding convention by, for example, specifying

one of the following options: (i) round the Delivery Amount and Return Amount down to the nearest integral multiple specified; or (ii) round the Delivery Amount up and the Return Amount down to the nearest integral multiple specified. If no rounding convention is specified, then the Delivery Amount and the Return Amount will not be rounded.

Parties would not ordinarily be expected to specify that both Delivery Amounts and Return Amounts are to be rounded up, as this could create conflicting obligations to transfer collateral and result in a Secured Party being undersecured.

While the parties may use a rounding convention as an alternative to a Minimum Transfer Amount (as both rounding and Minimum Transfer Amounts are, in essence, adjustments made to ease operational difficulties), some market participants maintain that this is not ideal from an operational perspective.

If, however, parties wish to use the rounding mechanism for this purpose, they could, for example, specify that (i) Delivery Amounts and Return Amounts below a specified level would be rounded down to zero and (ii) Delivery Amounts above that level would be rounded up and Return Amounts above that level would be rounded down, in each case to the nearest integral amount specified by the parties. In this way, market participants would obtain the same "minimum" that using a Minimum Transfer Amount would provide, without having to specify a separate rounding convention to eliminate uneven Delivery Amounts or Return Amounts.

Appendix C sets out examples of uses of the Minimum Transfer Amount and rounding conventions.

Cross-reference: Paragraph 3.

7. Paragraph 13(d): Valuation and Timing.

a. ***Valuation Agent.*** The Valuation Agent is responsible for calculating the Delivery Amount and the Return Amount and notifying the parties of these calculations pursuant to Paragraph 4(c) so that the Chargor and the Secured Party, as applicable, fulfil their credit support obligations under Paragraph 3.

The parties may specify one of the parties or a third party as the Valuation Agent. The parties may also specify different parties as Valuation Agent for different purposes. If the parties do not specify either of these options in Paragraph 13(d)(i), then the Valuation Agent is the party making the demand under Paragraph 3. As a result, the Secured Party would be the Valuation Agent for purposes of Paragraph 3(a) and Paragraph 6(g), while the Chargor would be the Valuation Agent for the purposes of Paragraph 3(b).

Cross-references: Paragraphs 3, 4, 5, 6(g) and 12 (definition of "Valuation Agent").

b. ***Valuation Date.*** The frequency of "Valuation Dates" represents the frequency with which the Transactions under the ISDA Master Agreement and the Posted Credit Support are marked to market. On each Valuation Date or other date for which

either Exposure or Value is calculated, the Valuation Agent is required to calculate, as of the Valuation Time (see below), the Exposure, the Value of Posted Credit Support (if any), the Credit Support Amount, the Delivery Amount (if any) and the Retun Amount (if any), and then notify the parties.

Parties *must* complete Paragraph 13(d)(ii) to indicate which days will be Valuation Dates, as there is no fallback position if the Valuation Dates are not specified. Parties may choose specific dates (for example, the 15th day of each month or, if that date is not a Local Business Day, the Local Business Day immediately following that date) or time periods (for example, daily, weekly, monthly) or they may instead use a determination method (for example, any Local Business Day which, if' treated as a Valuation Date, would result in a Delivery Amount or Return Amount).

If the parties require there to be a daily mark-to-market, they must specify that each Local Business Day is to be a Valuation Date, and they should also provide for the Valuation Agent to make its calculations pursuant to Paragraph 4(c) on a basis that will allow for daily transfers of Eligible Credit Support and Posted Credit Support. If the Valuation Agent is one of the parties, it may also be useful to make clear that a notice of the Valuation Agent's calculations can be combined with a demand for a Delivery Amount or a Return Amount.

Cross-references: Paragraphs 3, 4(c), 5, 6(g) and 12 (definition of "Valuation Date").

c. ***Valuation Time.*** The "Valuation Time" is the time as of which the Valuation Agent calculates the Exposure and the Value of Posted Credit Support (if any) for purposes of determining if there is a Delivery Amount or a Return Amount under Paragraph 3. It is also the time as of which the Secured Party calculates the Exposure and the Value of Posted Credit Support (if any) for purposes of determining if the Chargor is entitled to receive Distributions and the Interest Amount under Paragraph 6(g).

The parties must specify whether the Valuation Time will be: (i) the close of business on the Valuation Date (for purposes of Paragraph 3) or date of calculation (f'or purposes of Paragraph 6(g)); (ii) the close of business on the Local Business Day immediately preceding the Valuation Date (for purposes of Paragraph 3) or the Local Business Day immediately preceding the date of calculation (for purposes of Paragraph 6(g)); or (iii) determined in accordance with some other means selected by the parties. Once the parties have made this election (or otherwise specified a Valuation Time), the Deed requires that the calculation of both Exposure and Value be made as of approximately the same time on the date chosen.

Cross-references: Paragraphs 4(c), 6(g) and 12 (definition of "Valuation Time").

d. ***Notification Time.*** The "Notification Time" is the time by which, among other things, (i) the Valuation Agent must notify the parties of its calculations under Paragraph 4(c) on the Local Business Day following a Valuation Date and (ii) a party must make a demand for a transfer of Eligible Credit Support or Posted Credit Support, as

applicable, in order to be able to require the other party to make the appropriate transfer not later than the close of business on the next Local Business Day. If a demand for a transfer is made after the Notification Time, then the transfer is not required to be made until the close of business on the second Local Business Day following the day on which the demand was made. Such transfers are subject to satisfaction of the conditions precedent as set out in Paragraph 4(a) and the absence of any dispute as referred to in Paragraph 5.

The parties must specify whether 10.00 a.m. or 1.00 p.m. London time on the appropriate Local Business Day applies or may specify any other time as the Notification Time. Parties may wish to consider making the Notification Time for the Valuation Agent's calculations earlier than the Notification Time for demands for the transfer of a Delivery Amount or Return Amount, at least in cases where a third party acts as the Valuation Agent. In this way, a party receiving notice of the Valuation Agent's calculations will be able to make a demand on the same day for a transfer on the next Local Business Day.

Cross-references: Paragraphs 4(b), 5 and 12 (definition of "Notification Time").

8. Paragraph 13(e): Conditions Precedent and Secured Party's Rights and Remedies. Each party has certain rights under the Deed (unless otherwise specified in Paragraph 13), including, among other things:

a. the right of a party to make a demand for the transfer of Eligible Credit Support or Posted Credit Support, as applicable, under Paragraph 3 or 5;

b. the right of the Chargor to deliver Substitute Credit Support for Posted Credit Support under Paragraph 4(d); and

c. the right of the Chargor to receive a transfer of Distributions and Interest Amounts under Paragraph 6(g).

For a party to have these rights, however, the Deed requires that certain conditions precedent be satisfied as set out in Paragraph 4(a). These conditions include the absence of an Event of Default, Potential Event of Default or "Specified Condition" (discussed further below) in relation the party as well as the condition that no Early Termination Date for which any unsatisfied payment obligations exist has occurred in relation to the party. The existence of a "Specified Condition" with respect to the Chargor will also trigger the Secured Party's rights and remedies under Paragraph 8(a).

Paragraph 13(e) enables the parties to designate one or more Termination Events (or other events selected by the parties) as a "Specified Condition". Parties are also free to define "Specified Condition" differently for certain purposes under the Deed. For example, Illegality could be designated as a Specified Condition for purposes of Paragraph 4(a) but not for purposes at Paragraph 8(a), while "Credit Event Upon Merger" or an Additional Termination Event based on a ratings downgrade below a certain level could be designated as a Specified Condition for purposes of the Secured Party's rights and remedies under Paragraph 8(a). In general, parties may designate any Termination Event as a Specified Condition; however, parties should only specify an Additional Termination Event as a Specified Condition for

purposes of Paragraph 8(a) if it is also an Additional Termination Event for purposes of designating an Early Termination Date under the ISDA Master Agreement.

Cross-references: Paragraphs 4, 6, 8 and 12 (definition of "Specified Condition").

9. Paragraph 13(f): Substitution Date. Under Paragraph 4(d), the Chargor may give notice that it wishes to transfer new collateral (Substitute Credit Support) in substitution for existing collateral (Original Credit Support) held by the Secured Party. In its Substitution Notice, the Chargor is required to specify the Original Credit Support that it wishes to substitute.

If the Secured Party notifies the Chargor that it has consented to the substitution, the Chargor is obliged to transfer that Substitute Credit Support on the first Settlement Day following the Secured Party's notice of consent (which may be oral telephonic notice), and the Secured Party is obliged to transfer to the Chargor the Original Credit Support not later than the Settlement Day following the day on which the Secured Party receives the Substitute Credit Support, unless otherwise specified in Paragraph 13(f) (the "Substitution Date").

By changing the definition of Substitution Date, the parties may extend or reduce the time period in which the Secured Party must make its transfer of Posted Credit Support. This may be desirable for some types of collateral, where more time may be necessary to effect the transfer. In practice, the parties may find that the definition of "Settlement Day" is sufficiently flexible to accommodate all types of collateral the Chargor may wish to substitute.

Cross-reference: Paragraph 4(d).

10. Paragraph 13(g): Dispute Resolution

a. ***Resolution Time.*** The "Resolution Time" is the time by which parties involved in a dispute under Paragraph 5 must resolve their dispute. If they do not resolve their dispute by the Resolution Time, then the Valuation Agent (which may be the party making the demand) performs certain recalculations under Paragraph 5.

The parties *must* choose whether 1.00 p.m. or 3.00 p.m. London time on the Local Business Day following the date on which the notice is given that gives rise to a dispute under Paragraph 5 applies or they may choose an alternative time by which to resolve their dispute.

Parties may wish to change the language in Paragraph 13(g)(i) so that it refers to "the date on which notice of the dispute is given under Paragraph 5", rather than "the date on which notice is given that gives rise to a dispute under Paragraph 5". The latter phrase could be taken to be a reference to the Valuation Agent's notice of Exposure or Value, which is not intended.

Parties may also wish to specify that the requirement to transfer an undisputed amount of Eligible Credit Support or Posted Credit Support will not arise prior to the time that otherwise applied to that transfer pursuant to a demand made under Paragraph 3.

Cross-references: Paragraphs 5 and 12 (definition of "Resolution Time").

b. ***Value.*** Paragraph 5 requires that the parties provide in Paragraph 13(g)(ii) for a means by which the Valuation Agent can recalculate the Value of Posted Credit Support and the Value of any transfer of Eligible Credit Support in the event of a dispute. If this provision is not completed, the Valuation Agent will be unable to resolve such disputes in accordance with the terms of Paragraph 5. This provision *must* therefore be completed.

One alternative that parties may wish to specify is as follows:

"Any disputes over the Value of all or any portion of the Posted Credit Support or of any transfer of Eligible Credit Support or Posted Credit Support will be resolved by the Valuation Agent seeking three mid-market quotations as of the relevant Valuation Date or date of transfer from leading dealers in the relevant market for the securities or other property in question. The Value in each such case will be the arithmetic mean of the quotations received by the Valuation Agent."

Cross-references: Paragraphs 3, 4, 5, 11 and 12 (definition of "Value").

c. ***Alternative.*** Paragraph 5(a)(4)(i) states how a dispute involving the Valuation Agent's calculation of a Delivery Amount or a Return Amount is handled. Simply stated, the Valuation Agent recalculates that part of the Exposure attributable to the disputed Transactions by seeking four actual quotations at mid-market from Reference Market-makers for purposes of calculating Market Quotation and then takes the arithmetic mean of those quotations.

If, however, four quotations are not available for a particular disputed Transaction, then the Valuation Agent is permitted to use fewer than four quotations for that Transaction, and if no quotation is available, then the Valuation Agent's original calculations are used. The Valuation Agent recalculates the Value of Posted Credit Support (if disputed) by using the procedures in Paragraph 13(g)(ii) and then recalculates the Delivery Amount or Return Amount, as applicable.

If the parties elect to change this dispute resolution procedure, they should specify a different procedure in Paragraph 13(g)(iii).

Cross-reference: Paragraph 5.

11. Paragraph 13(h): Eligibility To Hold Posted Collateral; Custodians. Under Paragraph 6(b), each party, as the Secured Party, is entitled to hold Posted Collateral, provided that it satisfies the conditions specified in Paragraph 13(h)(i) that it is not a Defaulting Party. In addition, a Custodian (if any) appointed by a party also will be entitled to hold Posted Collateral, provided that the relevant Specified Party is not a Defaulting Party, and the Custodian satisfies the conditions (if any) specified in Paragraph 13(h)(ii).

Parties should consider whether to specify as a condition that all Posted Collateral may be held only in certain jurisdictions. Parties may add any additional conditions that they elect to include, such as a minimum credit rating requirement or total assets requirement with respect to the Custodian. Each party may specify a particular entity that initially will serve as its Custodian.

Cross-references: Paragraphs 6(b) and 12 (definition of "Custodian").

12. Paragraph 13(i): Distributions and Interest Amount.

a. ***Interest Rate***. The "Interest Rate" is the relevant rate that the parties agree will be applied to Posted Collateral held in the form of cash in each specified Eligible Currency and, subject to certain conditions, paid to the Chargor. This will normally be an appropriate rate corresponding to the period determined by the frequency of the "Valuation Dates". The Parties must complete this space if cash is an acceptable type of Eligible Collateral and the parties choose not to change (through Paragraph 13(i)(iii)) the provision entitling the Chargor to the Interest Amount.

Under Paragraphs 6(g)(ii) and 12 of the Deed, the Interest Amount for any Interest Period is the aggregate sum of the Base Currency Equivalents of the amounts of interest determined for each relevant currency. The Interest Amount is calculated for each day in that Interest Period on the principal amount of Posted Collateral in the form of cash in such currency using the equivalent of an Actual/360 (or 365, if the relevant currency is pounds sterling) day count fraction, as determined by the Valuation Agent.

Parties may prefer to amend the Interest Amount definition to provide that interest in relation to cash collateral in each currency is paid in the currency of the relevant collateral, rather than converted to the Base Currency, as noted above.

The Deed also provides in Paragraph 11(a) for Default Interest to be paid by the Secured Party in the event that it fails to transfer Posted Collateral or the Interest Amount when it is required to do so. In contrast to the Interest Rate provisions of Paragraph 6(g)(ii), Default Interest under Paragraph l 1(a) of the Deed is determined in the same manner as is provided for under the ISDA Master Agreement which uses the Default Rate and an Actual/Actual day count fraction (this provision, however, only applies to the Secured Party because Posted Collateral is treated as property in which the Chargor has a residual interest, while the Secured Party is entitled to hold it and use it to satisfy Obligations, the Chargor is entitled to earnings in the form of interest).

Parties should consult with their tax advisors as to whether any withholding taxes would result from the receipt of income on Posted Collateral or from the payment of Distributions or Interest Amounts and the characterisation of such payments. Parties may find helpful the general tax considerations set out in *Part III* of this Guide.

If any withholding taxes apply with respect to Posted Collateral, Paragraph l0(b) requires that the Chargor pay such withholding taxes.

b. ***Transfer of Interest Amount.*** Provided that the Secured Party would not become improperly undersecured by the transfer of any Interest Amount (treating each date of calculation as a Valuation Date), Paragraph 13(i)(ii) states that the Interest Amount will be transferred to the Chargor on the last Local Business Day of each calendar month and on any Local Business Day that a Return Amount consisting wholly or partly of cash is transferred to the Chargor pursuant to Paragraph 3(b). The parties may modify the timing of Interest Amount payments through Paragraph 13(i)(ii).

Pursuant to Paragraph 6(g)(i) of the Deed, all Distributions which the Secured Party receives or is deemed to receive on a Local Business Day must (subject to the satisfaction of all applicable conditions) be transferred to the Chargor, not later than the Settlement Day following each Distributions Date, to the extent that a Delivery Amount would not be created or increased as a result of such a transfer, as calculated by the Valuation Agent.

Failure of a Secured Party to transfer Distributions pursuant to Paragraph 6(g)(i) will be a Relevant Event under Paragraph 7(ii). The parties may modify the timing of transfers of Distributions (or the Valuation Date relating to those Distributions) in Paragraph 13(1) (Other Provisions).

c. ***Alternative to Interest Amount.*** The parties may elect not to provide the guaranteed rate of return on Posted Collateral in the form of cash that is achieved through the use of an Interest Rate and Interest Amount. The parties may specify, for example, that the Secured Party will invest Posted Collateral in the form of cash in good faith and transfer the proceeds of that investment to the Chargor pursuant to some agreed schedule instead of the Interest Amount that otherwise would have been transferred pursuant to Paragraph 13(i)(ii).

Cross-references: Paragraphs 6(g) and 12 (definitions of "Interest Amount", "Interest Rate" and "Interest Period").

13. Paragraph 13(j): Other Eligible Support and Other Posted Support.

a. ***Value.*** Parties that elect to permit Other Eligible Support to be included under the Deed must set out in Paragraph 13(j)(i) how that Other Eligible Support is to be valued. For example, if a letter of credit qualifies as Other Eligible Support, then the parties could define its "Value" as the amount then available to be unconditionally drawn upon by the Secured Party (subject only to the conditions to drawing specified in the letter of credit documentation). Without this information, the Valuation Agent or the Secured Party will be unable to take the letter of credit into account for purposes of performing the calculations under Paragraphs 3, 5 and 6(g).

b. ***Transfer of Other Eligible Support and Other Posted Support.*** Parties that elect to permit Other Eligible Support to be included under the Deed must set out in Paragraph 13(j)(ii) how that Other Eligible Support is to be transferred. For example, if a letter of credit qualifies as Other Eligible Support, then the parties could define an effective transfer with respect to that letter of credit to mean the creation of an unconditional right of the Secured Party for whose benefit the letter of credit is established to draw upon that letter of credit (subject only to the conditions to drawing specified in the letter of credit documentation). Without this information, it would be unclear whether and, if so, when the letter of credit becomes Other Posted Support, again making it difficult for the Valuation Agent or the Secured Party to take the letter of credit into account for purposes of performing the calculations under Paragraphs 3, 5 and 6(g).

Cross-references: Paragraph 12 (definitions of "Other Eligible Support", "Other Posted Support", "Posted Credit Support" and "Value").

14. Paragraph 13(k): Addresses for Transfers. Parties to the Deed should complete Paragraph 13(k) to identify the account details to which transfers of Eligible Credit Support, the Interest Amount (if applicable) and Posted Credit Support should be sent. These account details may be amended from time to time, either generally or in relation to specific transfers, by notice given to the other party in accordance with Paragraph l 1(e) of the Deed, which incorporates by reference Section 12 of the ISDA Master Agreement.

15. Paragraph 13(1): Other Provisions. Paragraph 13(1) provides the parties with a place to include additional provisions not covered elsewhere in the Deed, much like Part 5 of the Schedule to the ISDA Master Agreement.

B. Summary of Completion of Paragraph 13 of the Deed

1. Paragraph 13(a): Base Currency and Eligible Currency. If no modification is made, the Base Currency is United States Dollars. If no modification is made, the only Eligible Currency is the Base Currency.

2. Paragraph 13(b): Security Interest for "Obligations". If no additional obligations are specified in this subparagraph, then the Deed secures only present and future obligations under the ISDA Master Agreement and under the Deed.

3. Paragraph 13(c): Credit Support Obligations.

a. ***Delivery Amount, Return Amount and Credit Support Amount.*** If the parties do not specify an alternative definition for Delivery Amount, Return Amount or Credit Support Amount, then these terms will have the meanings provided in the Deed.

b. ***Eligible Collateral.*** In order for collateral of any type to constitute "Eligible Collateral", it must be so specified in Paragraph 13(c)(ii). The relevant "Valuation Percentage" applicable to each type of collateral should also be specified. There is no fallback provision applicable if the parties fail to specify Eligible Collateral.

c. ***Other Eligible Support.*** In order for other arrangements to constitute "Other Eligible Support", the parties must specify the acceptable types of "Other Eligible Support".

d. ***Thresholds.*** If the parties do not specify amounts for "Independent Amount", "Threshold" and "Minimum Transfer Amount" with respect to Party A and Party B, these amounts are defined to be zero. The appropriate rounding convention must be specified, as applicable. If no rounding convention is chosen, then the Delivery Amount and the Return Amount will not be rounded.

4. Paragraph 13(d): Valuation and Timing.

a. ***Valuation Agent.*** If the parties do not specify a Valuation Agent, then the Valuation Agent is the party making the demand under Paragraph 3 and, with respect to the valuation of Distributions and Interest Amount, as applicable, the Secured Party.

b. ***Valuation Date.*** The parties must specify how or when the Valuation Dates will occur to determine the frequency with which the Transactions under the ISDA Master Agreement and the Posted Credit Support are marked to market. There is no fallback provision.

c. ***Valuation Time.*** The parties must specify the Valuation Time. There is no fallback provision.

d. ***Notification Time.*** The parties must specify the Notification Time. There is no fallback provision.

5. Paragraph 13(e): Conditions Precedent and Secured Party's Rights and Remedies. If the parties do not designate any Termination Event as a "Specified Condition" in relation to a party, then Specified Conditions will not apply.

6. Paragraph 13(f): Substitution. If the parties do not specify a "Substitution Date", then the Substitution Date will be the Settlement Day following the date on which the Secured Party receives the Substitute Credit Support.

7. Paragraph 13(g): Dispute Resolution.

a. ***Resolution Time.*** The parties must specify the Resolution Time. There is no fallback provision.

b. ***Value.*** The parties must provide for a method of calculation to determine the Value of outstanding Posted Credit Support and of any transfer of Eligible Credit Support in the event of a dispute. There is no fallback provision.

c. ***Alternative.*** If the parties do not specify an alternative dispute resolution procedure, the procedures specified in Paragraph 5 will govern.

8. Paragraph 13(h): Eligibility to Hold Posted Collateral; Custodians. If the parties do not specify any conditions to holding Posted Collateral, then the only condition that will apply is that the Secured Party is not a Defaulting Party. The parties may also specify which entity is to be initially appointed as the Custodian in relation to each party as Secured Party.

9. Paragraph 13(i): Distributions and Interest Amount.

a. ***Interest Rate.*** If cash is an acceptable type of Eligible Collateral, then the parties must specify the relevant rate that will apply to cash held as Posted Collateral in each Eligible Currency. There is no fallback provision to determine such rate.

b. ***Transfer of Interest Amount.*** If the parties have not specified the time at which an Interest Amount will be transferred to the Chargor, then it will be transferred on the last Local Business Day of each calendar month and on any Local Business Day that a Return Amount consisting wholly or partly of cash is returned to the Chargor.

c. ***Alternative to Interest Amount.*** If the parties do not specify an alternative to Paragraph 6(g)(ii), then the Chargor will be entitled to the interest on cash collateral determined in accordance with that provision and the definition of "Interest Amount" in Paragraph 12.

10. Paragraph 13(j): Other Eligible Support and Other Posted Support. If parties specify types of Other Eligible Support, then they must specify how the "Value" of Other Eligible Support and Other Posted Support is to be calculated and must specify how the transfer of Other Eligible Support and Other Posted Support is to be effected.

11. Paragraph 13(k): Addresses for Transfers. The parties must specify the location for transfers of Eligible Credit Support, Interest Amount and Posted Credit Support, There are no fallback provisions.

12. Paragraph 13(1): Other Provisions. The parties may add additional modifications to the provisions of the Deed and/or additional provisions not covered elsewhere in the Deed.

C. The Annex: Paragraph 11. Elections and Variables

1. Paragraph 11(a): Base Currency and Eligible Currency. The "Base Currency" is defined as United States Dollars, unless the parties specify otherwise. The Base Currency is the common currency into which all values are converted for purposes of determining the adjusted aggregate exposure of the Transferor and the adjusted aggregate value of collateral on hand. Parties should therefore select the currency most convenient f'or purposes of collateral management.

"Eligible Currency" is defined as each of the Base Currency and any other freely available currency agreed and specified by the paities in this subparagraph. The term is used for purposes of defining each currency in which cash collateral may be denominated in Paragraph 13(c)(ii)(A).

Cross-reference: Paragraph l0 (definitions of "Base Currency", "Base Currency Equivalent" and "Eligible Currency").

2. Paragraph 11(b)(i): Delivery Amount, Return Amount, Credit Support Amount.

a. ***Delivery Amount.*** The Delivery Amount is, in essence, the amount of additional (or "top-up") collateral due as determined on any Valuation Date. It is defined in Paragraph 2(a) more precisely to mean, as of any Valuation Date, the amount by which the Credit Support Amount (in essence, the adjusted exposure) exceeds the Value of the Transferor's Credit Support Balance (in essence, the collateral on hand), as adjusted to reflect prior collateral movements (either way) that have not yet fully settled.

If the Delivery Amount exceeds the Minimum Transfer Amount (if any) applicable to the Transferor, then the Transferor will transfer Eligible Credit Support having a Value as of the date

of transfer at least equal to the Delivery Amount, rounded as specified in Paragraph 11(b)(iii)(D). In other words, the Delivery Amount is first compared to the Minimum Transfer Amount. If it does not exceed the Minimum Transfer Amount, then no transfer is due in respect of that Valuation Date. If it does exceed the Minimum Transfer Amount, then the Delivery Amount is rounded and the rounded amount is transferred.

Note that it is possible, in certain circumstances, that a Delivery Amount exceeds the Minimum Transfer Amount, but as a result of the agreed rounding convention, the rounded amount to be transferred is zero. Note also that there is no fallback Minimum Transfer Amount and no fallback rounding convention.

Parties may modify the definition of "Delivery Amount" in Paragraph 11(b)(i)(A) to adjust the method of calculating the amount of Eligible Credit Support that the Transferor must deliver to the Transferee. In general, if a change is made to "Delivery Amount", a corresponding change should be made to "Return Amount".

Cross-references: Paragraphs 2(a), 4, 5(c) and 10 (definition of "Delivery Amount").

b. ***Return Amount.*** The Return Amount is, in essence, the amount of excess collateral that may be drawn down by the Transferor as determined on any Valuation Date. It is defined in Paragraph 2(b) more precisely to mean, as of any Valuation Date, the amount by which the Value of the Transferor's Credit Support Balance (in essence, the collateral on hand) exceeds the Credit Support Amount (in essence, the adjusted exposure), as adjusted to reflect prior collateral movements (either way) that have not yet fully settled.

If the Return Amount exceeds the Minimum Transfer Amount (if any) applicable to the Transferee, then upon demand by the Transferor the Transferee will transfer Equivalent Credit Support specified by the Transferor in that demand having a Value as of the date of transfer as close as practicable to the Return Amount, rounded as specified in Paragraph 11(b)(iii)(D). In other words, the Return Amount is first compared to the Minimum Transfer Amount. If it does not exceed the Minimum Transfer Amount, then no transfer is due in respect of that Valuation Date. If it does exceed the Minimum Transfer Amount, then the Return Amount is rounded and the rounded amount is transferred.

Note that it is possible, in certain circumstances, that a Return Amount exceeds the Minimum Transfer Amount, but as a result of the agreed rounding convention, the rounded amount to be transferred is zero. Note also that there is no fallback Minimum Transfer Amount and no fallback rounding convention.

Parties may modify the definition of "Return Amount" in Paragraph 11(b)(i)(B) to adjust the method of calculating the amount of Equivalent Credit Support that the Transferee must return to the Transferor. In general, if a change is made to "Return Amount", a corresponding change should be made to "Delivery Amount".

Cross-references: Paragraphs 2(b), 4 and 10 (definition of "Return Amount").

c. ***Credit Support Amount.*** Unless modified by the parties, the "Credit Support Amount" is the amount of the Credit Support Balance that the Transferee is entitled to maintain as of a particular Valuation Date. In other words, it is the exposure of the Transferee to the Transferor, adjusted to reflect agreed thresholds, minimum transfer amounts and so on.

In Paragraph 10, the "Credit Support Amount" is defined on a Valuation Date as an amount equal to:

(i) the Transferee's Exposure; plus

(ii) all Independent Amounts applicable to the Transferor, if any; minus

(iii) all Independent Amounts applicable to the Transferee, if any; minus

(iv) the Transferor's Threshold, if any.

The Credit Support Amount is, however, deemed to be zero whenever its calculation would yield a number less than zero. In such circumstances, it is, of course, possible that collateral should flow in the other direction.

The elements of the "Credit Support Amount" definition may be summarised as follows:

(1) **Exposure:** the net amount (as estimated by the Valuation Agent for any Valuation Date or other date on which Exposure is calculated) that one party would owe to the other party if the ISDA Master Agreement were to be terminated on a complete no-fault basis (that is, as if there were a Termination Event with two Affected Parties; market participants sometimes refer to this as "full two-way payments").

(2) **Independent Amount:** an amount used as an add-on to Exposure, reflecting, among other things, the possible increase in Exposure that may occur between Valuation Dates due to the volatility of the mark-to-market values of the Transactions under the relevant ISDA Master Agreement or between a Valuation Date and the time delivery of additional Eligible Credit Support occurs. Note that the parties may express the Independent Amount as a fixed amount (per Transaction or overall) or as a formula (typically determined per Transaction, for example, as a percentage of Notional Amount). When an Independent Amount is applicable to a party, it increases the Credit Support Amount that is due by it when it is the Transferor and decreases the Credit Support Amount that is due to it when it is the Transferee.

When parties wish to specify in connection with a particular Transaction that an Independent Amount is to be transferred at the outset of that Transaction, they would in most cases be expected to specify in the related Confirmation both (i) the relevant amount (or means by which it is to be determined) and (ii) unless already provided in Paragraph 11, that the relevant Trade Date (or other agreed date) is to be a Valuation Date for purposes of the Annex.

(3) **Threshold:** the specified amount of risk (in monetary terms) that a party is willing to tolerate without requiring collateral from the other party (sometimes referred to as the "permitted unsecured risk").

If, as of a particular Valuation Date, the Credit Support Amount applicable to the Transferee exceeds the Value as of that date of the Transferor's Credit Support Balance, a Delivery Amount exists under Paragraph 2 of the Annex. Conversely, if, as of that Valuation Date, the Value of the Transferor's Credit Support Balance exceeds the Credit Support Amount applicable to the Transferee, a Return Amount exists under Paragraph 2.

Paragraph 11(b)(i)(C) enables the parties, if they wish, to substitute a different formula for determining the Credit Support Amount due in respect of each Valuation Date.

Some parties may wish to modify the method for determining the Credit Support Amount in order to eliminate the subtraction of Independent Amounts applicable to the Transferee from the calculation of Credit Support Amount. *Appendix B* of this Guide contains suggested modifications to Paragraph 11 where this result is desired.

Note that this increases the possibility, discussed in *Part I.B.1* of this Guide, of the parties being required to act in both capacities in respect of a Valuation Date, in other words, as Transferor in relation to one Credit Support Balance and Transferee in relation to another Credit Support Balance. For the reasons discussed above, this should not cause any difficulty as a practical matter.

Cross-reference: Paragraph 2.

3. Paragraph 11(b)(ii): Eligible Credit Support. Parties must specify the types of Eligible Credit Support that a party may provide to satisfy a Delivery Amount requirement in Paragraph 11(b)(ii). There is no fallback provision, so if the relevant types of Eligible Credit Support are not specified here, then the Annex will have no effect.

The parties may indicate the relevant types of Eligible Credit Support by ticking the appropriate space(s) in Paragraph 11(b)(ii) in relation to each party. The identity of the relevant government issuing negotiable debt obligations of differing maturities should be completed. Additional types of Eligible Credit Support may be added by specifying such collateral under the heading labelled "Other".

In relation to cash collateral, as discussed above, the relevant currencies in which cash collateral may be provided are specified under the heading "Eligible Currency" in Paragraph 11(a)(ii).

In relation to collateral in the form of securities, the parties may apply "haircuts" to the value of Eligible Credit Support by specifying a "Valuation Percentage" less than 100% for particular types of Eligible Credit Support. Applying a Valuation Percentage to an item of Eligible Credit Support will reduce the Value attributed to that item. This is achieved by multiplying the market value of the relevant security (determined as discussed below) by the Valuation Percentage applicable to that type of security. Thus, to apply a haircut of, say, 10% to a particular security, it is necessary to specify a Valuation Percentage of 90% in relation to that type of security.

This means that the Transferor is not given full credit, for purposes of determining the Return Amount or Delivery Amount in relation to Valuation Date, for the full value of the relevant security. In other words, in line with normal market practice for certain types of security, the security is deliberately under valued, thereby increasing the "top-up" collateral to be delivered or decreasing the excess collateral to be returned. This extra "cushion" of value is intended, among other things, to offset a possible decrease in value in the security between Valuation Dates or between the date of a default and the enforcement of the security interest against the relevant security. More volatile or less liquid securities tend to have lower Valuation Percentages (that is, higher haircuts) than less volatile or more liquid securities, such as G7 government securities.

Parties that do not wish to discount the value of a type of Eligihle Credit Support should specify the Valuation Percentage to be 100% in relation to that type.

Cross-references: Paragraphs 2, 3(a), 3(c), 4, 6, 7 and 10 (definition of "Eligible Credit Support").

4. Paragraph 11(b)(iii): Thresholds.

a. ***Independent Amount.*** As discussed above, the "Indepenclent Amount" in relation to a party is an amount that may be used as an add-on to Exposure to address, among other things, the volatility of a particular Transaction, the amount of' time that can pass between a determination of Exposure and the delivery of Eligible Credit Support as part of a Delivery Amount and the general credit-worthiness of that party. The parties may specify a single Independent Amount in relation to each party or a separate Independent Amount per Transaction. The Independent Amount(a) may be specified in relation to a party in Paragraph l l (b)(iii)(A) or in the relevant Confirmation for each Transaction. As noted above, an Inclependent Amount may he a specified currency amount or may he expressed as a formula (for example, as a percentage of the relevant Notional Amount or equivalent for each Transaction). If an Independent Amount is not specified, it is deemed to be zero.

Cross-references: Paragraphs 2 and 10 (definitions of "Credit Support Amount" and "Independent Amount").

b. ***Threshold.*** As discussed above, the "Threshold" is the amount of net exposure that a party as Transferee is willing to bear in relation to the other party as Transferor before it requires the delivery of collateral under the Annex. In other words, it is the permitted unsecured credit risk a party is willing to bear in relation to the other party. A Threshold may be a specified currency amount or may he expressed as a formuh (for example, as a percentage of the relevant Notional Amount). This amount is generally related to the credit quality of the other party and may be set to vary depending upon the credit rating of that party. If a Threshold is not specified, it is deemed to be zero.

Under the Annex, if as of the Valuation Time for particular Valuation Date the Transferee's Exposure (adjusted to reflect the agreed Independent Amounts) exceeds the Transferor's Threshold, then a Credit Support Amount exists. To the extent that this Credit Support Amount exceeds the Value of the Transferor's Credit Support Balance with the Transferee at that time, the Transferee can demand that the Transferor transfer Eligible Credit Support in an

amount equal to the amount of that excess, assuming it exceeds the relevant Minimum Transfer Amount (if any) and subject to the agreed rounding convention (if any), as set out in Paragraph 11.

For example, assuming at a Valuation Time on a Valuation Date that Party A has an Exposure of $3 (and no Independent Amounts have been specified) and that Party B's Threshold is $4, then Party B is not obliged to deliver any Eligible Credit Support under Paragraph 3. If, however, Party A's Exposure rises to $5 as of the Valuation Time for the next Valuation Date, then Party A can demand that Party B transfer $1 of Eligible Credit Support, that is, the amount by which Party A's Exposure ($5) exceeds Party B's Threshold ($4).

Some market participants may prefer to require the transfer of Eligible Credit Support for the *entire* amount of a party's Exposure once that party's Exposure reaches a certain amount, rather than simply the excess of the Exposure (adjusted to reflect the agreed Independent Amounts and less the Value of the Transferor's Credit Support Balance) over the Threshold. This, however, requires careful drafting to achieve.

Cross-references: Paragraphs 2 and 10 (definition of "Threshold").

c. ***Minimum Transfer Amount.*** In order to avoid the need to transfer a "nuisance" amount of Eligible Credit Support as a Delivery Amount or Equivalent Credit Support as a Return Amount, the parties may specify a "Minimum Transfer Amount" in relation to each party. The effect of this is, as discussed above, that a Delivery Amount or Return Amount determined in relation to a Valuation Date will only be transferred if it exceeds the relevant Minimum Transfer Amount.

The precise amount set in relation to each party will depend on a number of factors, including administrative convenience and the credit quality of each party. As with the Threshold, it may be set to vary depending upon the credit rating of the relevant party. If a Minimum Transfer Amount is not specified, it is deemed to be zero.

Because the Minimum Transfer Amount only establishes a "floor", it does not eliminate the possibility that parties will be required to deliver uneven amounts as Delivery Amounts or Return Amounts. If the parties wish to ensure that only round amounts are delivered under Paragraph 3, they must establish a rounding convention, as discussed below.

Cross-references: Paragraphs 2 and 10 (definition of "Minimum Transfer Amount").

d. ***Rounding.*** As mentioned in *c* above, the parties may establish a rounding convention to avoid the need to deliver Eligible Credit Support as a Delivery Amount or Equivalent Credit Support as a Return Amount in an amount that is otherwise uneven or difficult to obtain in the form requested. The parties may specify a rounding convention by, for example, specifying one of the following options: (i) round the Delivery Amount and Return Amount down to the nearest integral multiple specified; or (ii) round the Delivery Amount up and the Return Amount down to the nearest integral multiple specified. If no rounding convention is specified, then the Delivery Amount and the Return Amount will not be rounded.

Parties would not ordinarily be expected to specify that both Delivery Amounts and Return Amounts are to be rounded up, as this could create conflicting obligations to transfer collateral and result in a Transferee being undersecured.

While the parties may use a rounding convention as an alternative to a Minimum Transfer Amount (as both rounding and Minimum Transfer Amounts are, in essence, adjustments made to ease operational difficulties), some market participants maintain that this is not ideal from an operational perspective.

If, however, parties wish to use the rounding mechanism for this purpose, they could, for example, specify that (i) Delivery Amounts and Return Amounts below a specified level would be rounded down to zero and (ii) Delivery Amounts above that level would be rounded up and Return Amounts above that level would be rounded down, in each case to the nearest integral multiple specified by the parties. In this way, market participants would obtain the same "minimum" that using a Minimum Transfer Amount would provide, without having to specify a separate rounding convention to eliminate uneven Delivery Amounts or Return Amounts.

Appendix C sets out examples of uses of the Minimum Transfer Amount and rounding conventions.

Cross-reference: Paragraph 2.

5. Paragraph 11(c): Valuation and Timing.

a. ***Valuation Agent.*** The Valuation Agent is responsible for calculating the Delivery Amount and the Return Amount and notifying the parties of these calculations pursuant to Paragraph 3(b) so that the Transferor and the Transferee, as applicable, fulfil their credit support obligations under Paragraph 2.

The parties may specify one of the parties or a third party as the Valuation Agent. The parties may also specify different parties as Valuation Agent for different purposes. If the parties do not specify either of these options in Paragraph 11(c)(i), then the Valuation Agent is the party making the demand under Paragraph 2. As a result, the Transferee would be the Valuation Agent for purposes of Paragraph 2(a) and Paragraph 5(c), while the Transferor would be the Valuation Agent for the purposes of Paragraph 2(b).

Cross-references: Paragraphs 2, 3, 4, 5(c) and 10 (definition of "Valuation Agent").

b. ***Valuation Date.*** The frequency of "Valuation Dates" represents the frequency with which the Transactions under the ISDA Master Agreement and the Credit Support Balance are marked to market. On each Valuation Date or other date for which either Exposure or Value is calculated, the Valuation Agent is required to calculate, as of the Valuation Time (see below), the Exposure, the Value of the Transferor's Credit Support Balance (if any), the Credit Support Amount, the Delivery Amount (if any) and the Return Amount (if any), and then notify the parties.

Parties *must* complete Paragraph 11(c)(ii) to indicate which days will be Valuation Dates, as there is no fallback position if the Valuation Dates are not specified. Parties may choose specific dates (for example, the 15th day of each month or, if that date is not a Local Business Day, the Local Business Day immediately following that date) or time periods (for example, daily, weekly, monthly) or they may instead use a determination method (for example, any Local Business Day which, if treated as a Valuation Date, would result in a Delivery Amount or Return Amount).

If the parties require there to be a daily mark-to-market, they must specify that each Local Business Day is to be a Valuation Date, and they should also provide for the Valuation Agent to make its calculations pursuant to Paragraph 3(b) on a basis that will allow for daily transfers of Eligible Credit Support and Equivalent Credit Support. If the Valuation Agent is one of the parties, it may also be useful to make clear that a notice of the Valuation Agent's calculations can be combined with a demand for a Delivery Amount or a Return Amount.

Cross-references: Paragraphs 2, 3(b), 4, 5(c) and 10 (definition of "Valuation Date").

c. ***Valuation Time.*** The "Valuation Time" is the time as of which the Valuation Agent calculates the Exposure and the Value of the Transferor's Credit Support Balance (if any) for purposes of determining if there is a Delivery Amount or a Return Amount under Paragraph 2. It is also the time as of which the Transferee calculates the Exposure and the Value of the Transferor's Credit Support Balance (if any) for purposes of determining if the Transferor is entitled to receive Distributions and the Interest Amount under Paragraph 5(c).

The parties must specify whether the Valuation Time will be: (i) the close of business on the Valuation Date (for purposes of Paragraph 2) or date of calculation (for purposes of Paragraph 5(c)); (ii) the close of business on the Local Business Day immediately preceding the Valuation Date (for purposes of Paragraph 2) or the Local Business Day immediately preceding the date of calculation (for purposes of Paragraph 5(c)); or (iii) determined in accordance with some other means selected by the parties. Once the parties have made this election (or otherwise specified a Valuation Time), the Annex requires that the calculation of both Exposure and Value be made as of approximately the same time on the date chosen.

Cross-references: Paragraphs 3(b), 5(c) and 10 (definition of "Valuation Time").

d. ***Notification Time.*** The "Notification Time" is the time by which, among other things, (i) the Valuation Agent must notify the parties of its calculations under Paragraph 3(b) on the Local Business Day following a Valuation Date and (ii) a party must make a demand for a transfer of Eligible Credit Support or Equivalent Credit Support, as applicable, in order to be able to require the other party to make the appropriate transfer not later than the close of business on the next Local Business Day. If a demand for a transfer is made after the Notification Time, then the transfer is not required to be made until the close of business on the second Local Business Day following

the day on which the demand was made. Such transfers are subject to satisfaction of the conditions precedent as set out in Section 2(a)(iii) of the ISDA Master Agreement and the absence of any dispute as referred to in Paragraph 4.

The parties must specify whether 10.00 a.m. or 1.00 p.m. London time on the appropriate Local Business Day applies or may specify any other time as the Notification Time. Parties may wish to consider making the Notification Time for the Valuation Agent's calculations earlier than the Notification Time for demands for the transfer of a Delivery Amount or Return Amount, at least in cases where a third party acts as the Valuation Agent. In this way, a party receiving notice of the Valuation Agent's calculations will be able to make a demand on the same day for a transfer on the next Local Business Day.

Cross-references: Paragraphs 3(a), 3(b), 4 and 10 (definition of "Notification Time").

6. Paragraph 11(d): Exchange Date. Under Paragraph 3(c), the Transferor may give notice that it wishes to transfer new collateral (New Credit Support) in exchange for existing collateral (Original Credit Support) held by the Transferee. In its notice requesting the exchange, the Transferor is required to specify the Original Credit Support that it wishes to exchange.

If the Transferee notifies the Transferor that it has consented to the exchange, the Transferor is obliged to transfer that New Credit Support on the first Settlement Day following the Transferee's notice of consent (which may be oral telephonic notice), and the Transferee is obliged to transfer to the Transferor the Original Credit Support not later than the Settlement Day following the day on which the Transferee receives the New Credit Support, unless otherwise specified in Paragraph 11(d) (the "Exchange Date").

By changing the definition of Exchange Date, the parties may extend or reduce the time period in which the Transferee must make its transfer of Equivalent Credit Support. This may be desirable for some types of collateral, where more time may be necessary to effect the transfer. In practice, the parties may find that the definition of "Settlement Day" is sufficiently flexible to accommodate all types of collateral the Transferor may wish to exchange.

Cross-reference: Paragraph 3(c).

7. Paragraph 11(e): Dispute Resolution

a. ***Resolution Time.*** The "Resolution Time" is the time by which parties involved in a dispute under Paragraph 4 must resolve their dispute. If they do not resolve their dispute by the Resolution Time, then the Valuation Agent (which may be the party making the demand) performs certain recalculations under Paragraph 4.

The Resolution Time is specified to be 1.00 p.m. London time on the Local Business Day following the date on which the notice is given that gives rise to a dispute under Paragraph 4, unless the parties choose an alternative time by which to resolve their dispute.

Parties may wish to change the language in Paragraph 11(e)(i) so that it refers to "the date on which notice of the dispute is given under Paragraph 4", rather than "the date on which notice is given that gives rise to a dispute under Paragraph 4". The latter phrase could be taken to be a reference to the Valuation Agent's notice of Exposure or Value, which is not intended.

Parties may also wish to specify that the requirement to transfer an undisputed amount of Eligible Credit Support or Equivalent Credit Support will not arise prior to the time that otherwise applied to that transfer pursuant to a demand made under Paragraph 2.

Cross-references: Paragraphs 4 and 10 (definition of "Resolution Time").

b. ***Value.*** Paragraph 4 requires that the parties provide in Paragraph 11(e)(ii) for a means by which the Valuation Agent can recalculate the Value of the outstanding Credit Support Balance or of a transfer of Eligible Credit Support or Equivalent Credit Support in the event of a dispute. If this provision is not completed, the Valuation Agent will be unable to resolve such disputes in accordance with the terms of Paragraph 4. This provision *must* therefore be completed.

One alternative that parties may wish to specify is as follows:

> "Any disputes over the Value of all or any portion of the outstanding Credit Support Balance or of any transfer of Eligible Credit Support or Equivalent Credit Support will be resolved by the Valuation Agent seeking three mid-market quotations as of the relevant Valuation Date or date of transfer from leading dealers in the relevant market for the securities or other property in question. The Value in each such case will be the arithmetic mean of the quotations received by the Valuation Agent."

Cross-references: Paragraphs 2, 3, 4, 9 and 10 (definition of "Value").

c. ***Alternative.*** Paragraph 4(a)(4)(i) states how a dispute involving the Valuation Agent's calculation of a Delivery Amount or a Return Amount is handled. Simply stated, the Valuation Agent recalculates that part of the Exposure attributable to the disputed Transactions by seeking four actual quotations at mid-market from Reference Market-makers for purposes of calculating Market Quotation and then takes the arithmetic mean of those quotations.

If, however, four quotations are not available for a particular disputed Transaction, then the Valuation Agent is permitted to use fewer than four quotations for that Transaction, and if no quotation is available, then the Valuation Agent's original calculations are used. The Valuation Agent recalculates the Value of the Transferor's Credit Support Balance (if disputed) by using the procedures in Paragraph 11(e)(ii) and then recalculates the Delivery Amount or Return Amount, as applicable.

If the parties elect to change this dispute resolution procedure, they should specify a different procedure in Paragraph 11(e)(iii).

Cross-reference: Paragraph 4.

8. Paragraph 11(f): Distributions and Interest Amount.

a. ***Interest Rate.*** The "Interest Rate" is the relevant rate that the parties agree will be applied to the portion of the Transferor's Credit Support Balance comprised of cash in an Eligible Currency and, subject to certain conditions, paid to the Transferor. This will normally be an appropriate market rate corresponding to the period determined by the frequency of the "Valuation Dates". The Parties must complete this space if cash is an acceptable type of Eligible Credit Support and the parties choose not to change (through Paragraph 11(f)(iii)) the provision entitling the Transferor to the Interest Amount.

Under Paragraphs 5(c)(ii) and 10 of the Annex, the Interest Amount for any Interest Period is the aggregate sum of the Base Currency Equivalents of the amounts of interest determined for each relevant currency. The Interest Amount is calculated for each day in that Interest Period on the principal amount of the portion of the Credit Support Balance comprised of cash in such currency using the equivalent of an Actual/360 (or 365, if the relevant currency is pounds sterling) day count fraction, as determined by the Valuation Agent.

Parties may prefer to amend the Interest Amount definition to provide that interest in relation to cash collateral in each currency is paid in the currency of the relevant collateral, rather than converted to the Base Currency, as noted above.

The Annex also provides in Paragraph 9(a) for Default Interest to be paid by the Transferee in the event that it fails to transfer Equivalent Credit Support, Equivalent Distributions or Interest Amounts when it is required to do so. In contrast to the Interest Rate provisions of Paragraph 5(c)(ii), Default Interest under Paragraph 9(a) of the Annex is determined in the same manner as is provided for under the ISDA Master Agreement which uses the Default Rate and an Actual/Actual day count fraction.

Parties should consult with their tax advisors as to whether any withholding taxes would result from the payment of Equivalent Distributions or Interest Amounts and the characterisation of such payments. Parties may find helpful the general tax considerations set out in *Part III* of this Guide.

b. ***Transfer of Interest Amount.*** Provided that the Transferee would not become improperly undersecured by the transfer of any Interest Amount (treating each date of calculation as a Valuation Date), Paragraph 11(f)(ii) states that the Interest Amount will be transferred to the Transferor on the last Local Business Day of each calendar month and on any Local Business Day that a Return Amount consisting wholly or partly of cash is transferred to the Transferor pursuant to Paragraph 2(b). The parties may modify the timing of Interest Amount payments through Paragraph 11(f)(ii).

Pursuant to Paragraph 5(c)(i) of the Annex, in relation to all Distributions which the Transferee receives or is deemed to receive on a Local Business Day, the Transferee must (subject to the satisfaction of all applicable conditions) transfer Equivalent Distributions to the Transferor, not later than the Settlement Day following each Distributions Date, to the extent that a Delivery Amount would not be created or increased as a result of such a transfer, as calculated by the Valuation Agent.

The parties may modify the timing of transfers of Equivalent Distributions (or the Valuation Date relating to those Equivalent Distributions) in Paragraph 11(h) (Other Provisions).

c. ***Alternative to Interest Amount.*** The parties may elect not to provide the guaranteed rate of return on the portion of the Transferor's Credit Support Balance comprised of cash that is achieved through the use of an Interest Rate and Interest Amount. The parties may specify, for example, that the Transferee will invest any such cash in good faith and transfer the proceeds of that investment to the Transferor pursuant to some agreed schedule instead of the Interest Amount that otherwise would have been transferred pursuant to Paragraph 11(f)(ii).

Cross-references: Paragraphs 5(c) and 10 (definitions of "Interest Amount", "Interest Rate" and "Interest Period").

9. Paragraph 11(g): Addresses for Transfers. Parties to the Annex should complete Paragraph 11(g) to identify the account details to which transfers of Eligible Credit Support, the Interest Amount (if applicable) and Equivalent Credit Support should be sent. These account details may be amended from time to time, either generally or in relation to specific transfers, by notice given to the other party in accordance with Section 12 of the ISDA Master Agreement of which the Annex forms part.

10. Paragraph 11(h): Other Provisions. Paragraph 11(h) provides the parties with a place to include additional provisions not covered elsewhere in the Annex, much like Part 5 of the Schedule to the ISDA Master Agreement.

D. Summary of Completion of Paragraph 11 of the Annex

1. Paragraph 11(a): Base Currency and Eligible Currency. If no modification is made, the Base Currency is United States Dollars. If no modification is made, the only Eligible Currency is the Base Currency.

2. Paragraph 11(b): Credit Support Obligations.

a. ***Delivery Amount, Return Amount and Credit Support Amount.*** If the parties do not specify an alternative definition for Delivery Amount, Return Amount or Credit Support Amount, then these terms will have the meanings provided in the Annex.

b. ***Eligible Credit Support.*** In order for collateral of any type to constitute "Eligible Credit Support", it must be so specified in Paragraph 11(b)(ii). The relevant "Valuation Percentage" applicable to each type of collateral should also be specified. There is no fallback provision applicable if the parties fail to specify Eligible Credit Support.

c. ***Thresholds.*** If the parties do not specify amounts for "Independent Amount", "Threshold" and "Minimum Transfer Amount" with respect to Party A and Party B, these amounts are defined to be zero. The appropriate rounding convention must be specified, as applicable. If no rounding convention is chosen, then the Delivery Amount and the Return Amount will not be rounded.

3. Paragraph 11(c): Valuation and Timing.

a. ***Valuation Agent.*** If the parties do not specify a Valuation Agent, then the Valuation Agent is the party making the demand under Paragraph 3 and with respect to the valuation of Distributions and Interest Amount, as applicable, the Transferee.

b. ***Valuation Date.*** The parties must specify how or when the Valuation Dates will occur to determine the frequency with which the Transactions under the ISDA Master Agreement and the Credit Support Balance are marked to market. There is no fallback provision.

c. ***Valuation Time.*** The parties must specify the Valuation Time. There is no fallback provision.

d. ***Notification Time.*** The parties must specify the Notification Time. There is no fallback provision.

4. Paragraph 11(d): Exchange Date. If the parties do not specify an "Exchange Date", then the Exchange Date will be the Settlement Day following the date on which the Transferee receives the New Credit Support.

5. Paragraph 11(e): Dispute Resolution.

a. ***Resolution Time.*** If the parties do not specify an alternative, the Resolution Time is 1.00 p.m. London time on the Local Business Day following the date on which the notice is given that gives rise to the dispute.

b. ***Value.*** The parties must provide for a method of calculation to determine the Value of the outstanding Credit Support Balance and of any transfer of Eligible Credit Support or Equivalent Credit Support in the event of a dispute. There is no fallback provision.

c. ***Alternative.*** If the parties do not specify an alternative dispute resolution procedure, the procedures specified in Paragraph 4 will govern.

6. Paragraph 11(f): Distributions and Interest Amount.

a. ***Interest Rate.*** If cash is an acceptable type of Eligible Credit Support, then the parties must specify the relevant rate that will apply to cash comprised in the Credit Support Balance in each Eligible Currency. There is no fallback provision to determine such rate.

b. ***Transfer of Interest Amount.*** If the parties have not specified the time at which an Interest Amount will be transferred to the Transferor, then it will be transferred on the last Local Business Day of each calendar month and on any Local Business Day that a Return Amount consisting wholly or partly of cash is transferred to the Transferor.

c. ***Alternative to Interest Amount.*** If the parties do not specify an alternative to Paragraph 5(c)(ii), then the Transferor will be entitled to the interest on cash collateral determined in accordance with that provision and the definition of "Interest Amount" in Paragraph 10.

7. Paragraph 11(g): Addresses for Transfers. The parties must specify the location for transfers of Eligible Credit Support, Equivalent Credit Support and Interest Amounts. There are no fallback provisions.

8. Paragraph 11(h): Other Provisions. The parties may add additional modifications to the provisions of the Annex and/or additional provisions not covered elsewhere in the Annex.

III. TAX CONSIDERATIONS

A. General

Paragraph 10(a) of the Deed and Paragraph 8 of the Annex each provides that each party will pay any stamp, transfer or similar transaction tax or duty payable on any transfer it is required to make under the document. Paragraph 10(b) of the Deed also provides that the Chargor will pay when due any tax, assessment or charge of any nature arising in relation to the Posted Credit Support held by the Secured Party. There is no comparable provision in the Annex. Any property transferred under the Annex is transferred outright, and therefore any tax, assessment or charge in relation to the transferred property is, after the transfer, properly a matter for the Transferee.

In addition to the foregoing, there are a number of possible tax issues that a party intending to enter into the Deed or the Annex may wish to consider, including, among other things:

1. whether any of the following would constitute an *acquisition* by the receiving party or would otherwise cause profits and losses relating to collateral to be taken into account for tax purposes:

    a. receipt of or enforcement against collateral by the Secured Party under the Deed;

    b. receipt of collateral by Transferor or Transferee under the Annex; or

    c. the occurrence of an Early Termination Date as a result of an Event of Default;

2. whether any of the following would constitute a *disposal* by the transferring party or would otherwise give rise to a crystallisation of profit or loss for the transferring party for tax purposes:

    a. return/release of collateral by the Secured Party under the Deed;

    b. enforcement against collateral under the Deed (for which purpose the "transferring party" would be the Chargor);

    c. transfer of collateral by Transferor or Transferee under the Annex; or

    d. the occurrence of an Early Termination Date as a result of an Event of Default;

3. whether the posting of collateral by the Chargor under the Deed or transfer of collateral by the Transferor or Transferee under the Annex gives rise to any stamp duty or transfer taxes in any relevant jurisdiction (which may include not merely the jurisdiction of residence of the parties but also the jurisdiction of the issuer of any securities concerned or the jurisdiction of a depository holding such securities);

4. whether the payment of distributions relating to securities collateral by the collateral taker or interest in relation to cash collateral by the collateral taker is subject to withholding tax;

5. whether the payment of distributions relating to securities provided as collateral is subject to any increased withholding tax by virtue of being provided as collateral;

6. whether the answers to 1 through 5 above depend on whether the collateral is cash, debt securities or equity securities and/or on the currency in which such cash or securities are denominated; and

7. whether any of the considerations above leads to a taxation treatment that does not follow the economics of the transaction.

These issues should be considered from the perspective of taxation of capital gains/losses, taxation of income, taxation of "manufactured" income, taxation of foreign exchanges gains and losses; and transaction or exchange taxes, duties, levies and so on.

It would generally be anticipated that, if any of the above apply, it is more likely to apply in relation to the Annex than in relation to the Deed. A title transfer collateral arrangement, such as that exemplified by the Annex, bears a structural similarity to a securities repurchase (repo) transaction, which is also typically based on full transfer of ownership to the relevant securities. The tax analysis applicable to repo transactions may, therefore, be of relevance by analogy when considering the tax treatment of the arrangements contemplated by the Annex.

In all cases, however, appropriate local law advice should be taken.

B. United Kingdom Tax

The following section on United Kingdom tax issues is intended to be illustrative and is for general guidance only. It does not purport to be exhaustive and it should not be relied upon in specific cases, for which definitive advice should be sought. Note also that this summary reflects the UK position at the time of publication of this Guide (March 1999). Tax laws, regulations and policy are subject to change.

1. The Deed. Posting of collateral under the Deed is recognised for UK tax purposes as being merely the granting of a security interest. Ownership of the collateral is regarded as being held throughout by the Chargor unless the charge is enforced on occurrence of default. The posting of collateral is not regarded as giving rise to a tax event and gives rise to nil or nominal stamp duties only.

Where, however, the collateral is in the form of (i) debt or equities issued by a non-UK entity or (ii) gross-paying eurobonds issued by a UK entity, if the Secured Party is acting through a UK office then it will be treated as a UK "collecting agent" for UK tax purposes and accordingly may be subject to a withholding tax obligation (the principal exemption being where the Chargor is not UK tax-resident). The rate of the withholding tax is currently normally 20 per cent.

2. The Annex. The United Kingdom tax position in relation to the Annex is not as straightforward as it is for the Deed. For a more detailed explanation of UK tax issues arising from the use of the Annex, parties are referred to the ISDA publication "Guidance on UK Tax Issues Arising from the Use of the Annex - English law". A summary of the United Kingdom tax position is as follows:

a. The transfer of collateral (whether in the form of cash or securities) by the Transferor under the Annex is not normally regarded as a tax event unless and until there is an Early Termination Date under the ISDA Master Agreement without the collateral having been transferred back to the Transferor. Collateral that has not been transferred back to the Transferor

prior to the Early Termination Date will be treated as being disposed of by the Transferor for a consideration equal to the value attributed to that collateral by the Transferee for purposes of Paragraph 6 of the Annex.

b. Although it is believed that a similar analysis should apply for UK stamp duty/stamp duty reserve tax purposes, when this matter was raised with the Inland Revenue Stamp Office, the initial view of the Stamp Office was that transfers are subject to full stamp duty. However, stamp duty/stamp duty reserve tax is only relevant to transfers of UK equities and non-standard UK loan stock (such as convertibles), and in relation to on-exchange transfers of equities the discussions with the Stamp Office were superseded by a statutory amenclment to the effect that the stamp duty/stamp duty reserve tax position for such equities is similar to that described in *a*. above.

c. Withholding tax issues arise in relation to collateral in the form of cash and in the form of securities.

(i) Where cash is used as collateral under the Annex, the Transferee may be required to pay Interest Amounts to the Transferor. Those Interest Amounts are interest for UK tax purposes and a withholding tax obligation arises (A) unless one of the parties is a bank for UK tax purposes (and, where that party is the Transferee, it is acting in the ordinary course of its business) and (B) if the interest payable is regarded as "yearly" interest.

Whether Interest Amounts under the Annex would constitute "yearly" interest depends on whether parties expect that the cash collateral will be provided for a period of more than a year. Normally, the parties' expectation is merely that the cash is provided simply until the market movement which gave rise to its provision is reversed. Therefore the parties generally expect that at any time any collateral may be re-transferred. Accordingly, although the Inland Revenue take the view that in determining whether Interest Amounts constitute yearly interest all the relevant facts have to be taken into account, they would not normally disturb a view taken by the parties that the payments are not yearly interest.

(ii) Where a distribution is paid on a security transferred to the Transferee under the Annex, the Transferee is required to pay an Equivalent Distribution to the Transferor. This payment will be a "manufactured payment" for UK tax purposes, and it will generally be the case that for debt securities no difficulties should arise in practice. In other words, the income represented by the "manufactured payment" will be recognised as income of the Transferor, and any income arising from the transferred securities used by the Transferee to fund that "manufactured payment" will not be chargeable income to the Transferee.

For equities some difficulties may arise, particularly in relation to overseas equities in relation to which dividends either are paid under deduction of tax or carry an associated tax credit.

IV. COMPARISON OF THE DEED TO THE ANNEX

Parties may find it helpful to consider the following comparison of the Deed to the Annex, particularly for purposes of determining which is most appropriate in a particular case. The relative importance of each factor and any other factor known to the parties will, of course, be a matter for the individual judgement and agreement of the parties in each case. Note that both the Deed and the Annex are compared to the New York CSA in *Part V* below.

A. Formal Validity

Parties will want to ensure the formal validity of the collateral arrangement they have chosen against a liquidator, bankruptcy trustee, receiver or other insolvency official in relation to a counterparty and against third parties.

As the Deed involves creation of a security interest, the rules relating to the creation and formal validity (perfection) of the security interest will generally be more complex than those relating to the Annex. The principal issues relating to the formal validity of the Annex concern (1) whether or not the Annex would be recharacterised under applicable law as a form of security interest (in which case the considerations relevant to the Deed would apply) and (2) assuming the Annex would not be recharacterised, whether under applicable law the Credit Support Balance under the Annex can validly be included within the close-out netting effected in Section 6(e) of the related ISDA Master Agreement.

These issues are discussed in more detail below.

1. The Deed. Where the Deed is used, parties will need to ensure that (a) the security interest has been validly created under its governing law (which, unless amended by the parties, will be English law) and (b) any further steps necessary to ensure the formal validity of the security interest against third parties have been properly taken in each jurisdiction where collateral is held by the Secured Party under the Deed. The steps referred to in *(b)* are often referred to as "perfection" requirements in common law countries.

In addition, as discussed further below, there may be a registration or similar requirement in the jurisdiction of organisation of the counterparty (such as the registration of charges provisions under section 395 of the UK Companies Act 1985) and, possibly, in any jurisdiction where a branch of the counterparty is located for purposes of the relevant ISDA Master Agreement. This registration or similar requirement may affect the formal validity of the security interest against third parties (as, for example, in the case of the UK registration requirement), or it may merely be a corporate law requirement with no consequences for the validity of the security interest (as, for example, in the case of the Cayman Islands registration requirement).

In practice, valid creation of a security interest is not usually difficult, assuming both parties have the necessary legal power (capacity) and authority to grant security. The precise formalities will, of course, depend on the governing law of the security document and on certain other factors as well, including the nature of the relevant collateral. Essentially, though, it involves not much more than the execution of a properly drafted document such as the Deed.

Perfection of the security interest is, however, a different matter. Perfection is a term that encompasses any of the actions that may need to be taken to ensure the formal validity and (often) the priority of a security interest. Examples of such actions include the registration of the security interest or filing of a statutory notice with a relevant governmental official, notification of the security interest to a custodian holding the relevant collateral, entry of collateral in the form of book-entry securities in a special "pledged account" and delivery of possession of collateral to the Secured Party. Whether or not any of these or any other perfection requirements apply in a particular case depends on the nature and location of the collateral and the nature and location of the counterparty.

As to the nature of the collateral, the perfection requirements applicable to securities will often be different from the perfection requirements applicable to cash collateral. Even in relation to securities, the perfection requirements may vary according to whether the securities are (i) debt or equity, (ii) bearer or registered, (iii) in physical form or book entry form and (iv) held directly, with a single custodian or through a chain of intermediary custodians and clearing systems.

As to the location of the collateral, this can raise difficult conflict of laws questions, particularly in relation to securities held in book-entry form through a chain of intermediaries. A single security might, for example, be deemed to be located where the issuer of the security has its head office or, if the security is registered, where the relevant register is kept or, if in physical form, where the physical securities are located or, if held through a chain of intermediaries, where the intermediary closest to the Secured Party is located.

In practice, parties' legal advisers can help work out the matrix of rules for determining location of different types of collateral, and parties can then investigate what perfection requirements, if any, apply. In the United States, the conflict of laws position has been considerably simplified in most US States (including New York) by the introduction of revised Article 8 of the Uniform Commercial Code. Revised Article 8 provides, in effect, that the location of a party's interest in fungible book-entry securities is the place of location of the financial intermediary with whom the party holds its account for those securities. This means that for purposes of perfecting a security interest in securities held in, for example, a New York clearing system, one need only comply with New York law, notwithstanding that the securities may ultimately be held by another custodian located outside of New York through a chain of intermediaries who may or may not be located in New York.

Article 9(2) of the EU Settlement Finality Directive requires member states of the European Union to implement legislation achieving a similar result. As noted in *Part I.B.3* of this Guide, the provisions of the Settlement Finality Directive, including Article 9(2), must be implemented by each member state by 11 December 1999.

As to the nature and location of the counterparty, while these will in practice be less important and more straightforward matters to determine, parties should bear in mind the possibility that, depending on the nature of the counterparty, the parties may need to comply with additional formalities in the home jurisdiction of each party (viewed in its capacity as Chargor) and/or in any other jurisdiction in which it is located for purposes of the related ISDA Master Agreement. For example, in relation to an English counterparty, if it is organised under the UK Companies Acts, a certain type of charge granted by the English counterparty may require registration with the UK Registrar of Companies. Under the same statute a foreign counterparty with an established place of business in England or Wales will also need to register certain types of charge if any of the collateral is located in England or Wales.

2. The Annex. Where the Annex has been chosen, parties need to be sure that the arrangement will be enforced *as written* and that it will not be recharacterised as a form of security interest. The parties also need to know that the netting or set-off contemplated by the arrangement will be effective upon a counterparty's insolvency. As the right to set off or to net the net exposure under the Transactions against the value of the collateral under the Annex is not, in itself, a proprietary right but merely a contractual one, there are generally no special formalities to observe in creating or perfecting that right.

B. Other Issues

1. Nature of Collateral. Parties may wish to use cash and/or securities as collateral. In relation to securities, current market practice suggests that parties will commonly specify government securities (though the Deed also allows parties to specify corporate debt securities, including securities issued by emerging market issuers, and/or equity securities).

2. Use of Collateral. It is often important commercially for the collateral taker to have the unrestricted right to use securities received as collateral until the collateral must be returned to the collateral provider under the terms of the relevant Credit Support Document. This unrestricted use includes the ability to sell the securities to a third party in the market, free and clear of any interest of the collateral provider. Other uses would include lending the securities or selling them under a securities repurchase (repo) agreement or repledging (or recharging) them.

In this context, the term “rehypothecation” is used, although this term is best avoided as its commercial meaning differs from its legal meaning, which can give rise to confusion when consulting local counsel on the enforceability of this type of provision. Commercially, the term “rehypothecation” is generally used to signify *any* use of collateral by a collateral holder (including sale and repo) whereas its strict meaning is merely to repledge. In many jurisdictions repledging is permitted, under certain conditions, while a broader use of the collateral by the collateral taker is not.

If the collateral holder needs unrestricted use of the collateral, the collateral holder will not want to use the Deed as under the Deed the Secured Party is not permitted to use the collateral. The collateral holder will instead prefer to use the Annex. Under the Annex, the Transferee owns any assets transferred to it under the Annex, and therefore is completely free to do what it likes with such assets.

3. Enforceability of the Deed and the Annex. In deciding which form is most appropriate, parties will also need to consider whether the Deed or the Annex will be enforceable in a counterparty's home jurisdiction and in any other relevant jurisdiction. Other relevant jurisdictions, as noted elsewhere in this Guide, include any jurisdiction where collateral is located and also, possibly, any jurisdiction where a branch of the counterparty is located for purposes of the relevant Master Agreement.

Although the Annex is in many ways the simplest and most straightforward form of collateral arrangement, it may not be enforceable in jurisdictions that do not permit netting or insolvency set-off. Also, as noted above, in some jurisdictions the title transfer approach used in the Annex may be vulnerable to recharacterisation as a security interest.

4. Registration. An important disadvantage of using the Deed is the possible requirement that the Deed be registered under section 395 of UK Companies Act 1985. (As explained in *Part I.B.6* of, and referred to elsewhere in, this Guide.)

5. Global Custodians and Clearing Systems. In relation to the Deed, some potentially difficult issues may arise, particularly for conflict of laws purposes, where, as is typically the case, the securities that are taken as collateral are held in fungible form in global custody and/or in a clearing system. The problems that arise in connection with global custody and clearing systems differ according to (1) the nature of the agreements between the customers and their global custodian and/or between participants in a clearing system and the clearing system and (2) the laws of the place where the custodian or clearing system is located and/or where the underlying securities are held by the custodian or clearing system or a subcustodian for the custodian or clearing system.

The common theme, however, is the necessity to ascertain the precise nature of the asset over which the security interest is being taken. Is it a mere contractual right against the custodian or clearing system? Is it a "see-through" proprietary interest in securities held further up the chain (for example, in securities held in physical bearer form in the vault of a sub-custodian)? Or is it some intermediate property right (akin, for example, to a common law trust right) in the custodian's or clearing system's own interest in property further up the chain of intermediaries?

As discussed elsewhere in the Guide, these concerns have been ameliorated by statute in some jurisdictions (and subject, of course, to the limitations of the statute), most notably in the case of revised Article 8 of the US Uniform Commercial Code, adopted in many states of the United States, including New York, and in the case of the EU Settlement Finality Directive, which is to implemented in the member states of the European Union by 11 December 1999.

The conceptual difficulties referred to above are potentially a problem in relation to the Deed since the parties need to be sure they properly understand the nature of the collateral asset and also where it is deemed to be located under conflict of laws rules in order to be sure that they have complied with the correct requirements to ensure formal validity (in other words, the correct perfection requirements).

Consider, for example, the case of Dutch Guilder eurobonds held in an account in the Euroclear system in Brussels and, on behalf of Euroclear, in physical form in the vault of a sub-custodian in Amsterdam. Assume that this collateral has been transferred from one party to the other under the Deed by debiting one account in Euroclear and crediting another account in Euroclear. Is the relevant collateral a contractual or proprietary claim against Euroclear, in which case perfection would be governed (presumably) by Belgian law, or is it a "see-through" proprietary interest in the physical bonds held in Amsterdam, in which case perfection would be governed (presumably) by Dutch law, or is it some third or fourth possibility? Furthermore, under whose law does one need to make this determination? Under the governing law of the Deed (English law) or under the law of the place of incorporation of the collateral giver or under some other law?

As the difficulties discussed above concern perfection requirements, they affect the Deed but not (at least not to the same extent) the Annex. These issues are of some relevance to the Annex, nonetheless. It is not clear under current English law whether, if a title transfer collateral arrangement such as that set out in the Annex would be recharacterised as a security interest under the *lex situs* of the collateral (that is, under the laws of the place of location where the Transferee holds the collateral taken under the Annex), an

English court would defer to the *lex situs* notwithstanding that the Annex would not be recharacterised as a matter of English law. The better and more commercially sensible view is that an English court would not recharacterise the arrangement simply because it was recharacterised under the *lex situs* of the collateral. Such a recharacterisation would fly in the face of the clear intentions of the parties (assuming the true agreement of the parties is a sale, as provided under the express terms of the Annex in its published form), but it appears that English conflict of laws rules are not entirely clear on this point at the time of publication of this Guide (March 1999).

6. Tax Considerations. As set out in *Part III* of this Guide, tax considerations may affect parties' choice of the Deed or the Annex. As a general matter, tax is more likely to be of concern in relation to the title transfer approach reflected in the Annex.

7. Negative Pledges. If a counterparty has entered into a negative pledge that would prohibit it granting security, and therefore prohibit it entering into the Deed, the parties might nonetheless be able to put in place the Annex if the negative pledge does not also cover set-off, netting or similar arrangements. The precise wording of the negative pledge will need to be considered carefully by the parties' legal advisers before a decision is taken to use the Annex in such circumstances.

8. Insolvency Stays or Freezes. As the Deed reflects the security interest approach, it is likely to be caught by an insolvency stay or freeze. The Annex, reflecting the title transfer approach, may, however, not be caught by such a stay or freeze. For example, the Annex will not be caught by the freeze imposed by sections 10 and 11 of the UK Insolvency Act 1986 in the event of an administration, a form of reorganisation proceeding in the UK.

Insolvency stays or freezes do, however, in some countries catch the exercise of set-off rights. As the Annex relies on netting for its effectiveness, the Annex should be effective in any jurisdiction in which close-out netting is otherwise enforceable. This should, however, of course, always be checked with local counsel. Where netting is effective in a jurisdiction only where a netting statute applies, then if as one of the conditions of that statute each relevant transaction must fall within a specified definition of transactions eligible for netting under the statute, it is important to determine whether the Annex would constitute an eligible transaction for this purpose. More recent netting statutes often do away with such a condition, in which case the issue should not arise.

The foregoing is not necessarily an exhaustive discussion of differences between the Deed and the Annex, but reflects various considerations parties may wish to take into account when deciding whether to use the Deed or the Annex with a particular counterparty.

V. COMPARISON TO THE NEW YORK CSA

Users of this Guide may find it helpful to compare the provisions of the Deed and the Annex, respectively, with those of the New York CSA.

As in the case of the Deed and the Annex, the New York CSA is intended for use in documenting bilateral security and other credit support arrangements between counterparties for transactions documented under an ISDA Master Agreement. While the purpose of each of the New York CSA, the Deed and Annex are substantially the same, there are certain legal and operational differences between the different forms of collateral arrangement, which are summarised below. Capitalised terms used below have the meaning given those terms in the Deed, the Annex, the New York CSA or the ISDA Master Agreement, as appropriate according to context.

A. The Deed and the New York CSA

1. Key Similarities.

Both documents are primarily intended to create a security interest in collateral, principally in the form of securities and cash. Both also, however, provide contractual rights of set-off against collateral in certain circumstances.

Each document is intended to secure the net exposure arising under an ISDA Master Agreement, on the basis of the mark-to-market mechanics described in relation to the Deed in *Part I* of this Guide.

Each document contemplates the possibility of "Other Posted Support". This concept is explained in relation to the Deed in *Part I* of this Guide and in relation to the New York CSA in the ISDA User's Guide to the New York CSA. It means that the necessary mechanics have been built into each form to make it possible to provide credit support in the form of a letter of credit or guarantee or similar instrument (which are forms of personal security, relying not on the value of specific assets but on the personal credit of a third party). Any such Other Posted Support would be taken into account for purposes of determining the additional collateral (the Delivery Amount), if any, due on each Valuation Date.

Both the Deed and the New York CSA provide in Paragraph l 3 (Elections and Variables) for parties to agree and state those events that constitute a Specified Condition which may constitute a condition precedent with respect to the party transferring collateral to the Secured Party.

2. Key Differences.

a. ***Stand-alone Document.*** The Deed is a stand-alone document. As discussed above in this Guide, there is no particular advantage under English law in having the Deed as an annex to the ISDA Master Agreement. Furthermore, it is customary for a charge covering securities to be executed as a deed. This is (i) to have the benefit of certain statutory powers implied into a charge executed as a deed by section 101 of the UK Law of Property Act 1925 and (ii) to permit the Secured Party, under the power of attorney conferred by Paragraph 8(b) of the Deed, to execute any further documents as deeds, where necessary, under the "further assurances" provision. In the latter case, if an attorney (under US law, an "attorney-in-fact") is to have the power to execute deeds, then that power must itself be conferred by deed.

The ISDA Collateral Documentation Working Group in London (the "Working Group") concluded that it was unattractive from a commercial point of view to require the execution of an ISDA Master Agreement, containing an annexed security document, as a deed. Having a stand-alone document facilitates execution as a deed.

There also remains the concern that the Deed may be registrable in certain circumstances under section 395 of the UK Companies Act 1985. In the event that registration is thought to be required, or at least desirable for the sake of caution, the Working Group concluded that it would be easier as a practical matter to register a separate document rather than an ISDA Master Agreement containing, as an annex, a security document. Experience with such registrations at Companies House since the English law Credit Support Documents were published in 1995 has borne this out.

In contrast the New York CSA supplements, forms part of and is subject to the ISDA Master Agreement and is part of its Schedule.

b. ***Multicurrency Provisions.*** The Deed is a multicurrency form. The New York CSA is a single currency form. In other words, the Deed is intended to cover cash collateral and securities denominated in various currencies, while the New York CSA is intended to be used only with US Dollar cash and securities. For this reason there are specific provisions to convert all values to a Base Currency in the Deed, while such provisions are, of course, not included in the New York CSA.

This is important to bear in mind if considering use of the New York CSA with non-US Dollar collateral (for example, collateral denominated in Canadian Dollars or in an European or Asian currency). In such a case, currency conversion mechanics would need to be added to the New York form.

c. ***Timing and Settlement Differences.*** The Deed contemplates taking securities located in various jurisdictions, while the New York CSA is intended primarily to be used with US Treasuries. In the Deed, it was thought that a more generic provision relating to timing of deliveries and settlement mechanics was needed than is provided in the New York CSA.

Generally in the New York CSA, transfers are required to occur within one Local Business Day. In the Deed, transfers are required to occur as soon as practicable in accordance with custom and practice in the relevant market after receipt of a demand for a Delivery Amount or Return Amount, as the case may be. This is to allow for differences in settlement timing and practice in different markets and settlement systems across Europe. For example, the settlement timing and practice for settlement of Italian government bonds (BTPs) in the Euroclear system and in Cedel differ from the settlement timing and practice in the Italian domestic settlement system.

d. ***Delivery Amount and Return Amount.*** In determining whether a Delivery Amount or a Return Amount is required to be made in relation to a Valuation Date, the Deed provides for an adjustment to the value of the collateral held by the Secured Party on a Valuation Date to take account of any transfer of a prior Delivery Amount or Return Amount that is in course and has not yet fully settled as at that Valuation Date. This reflects the fact that a

settlement period may last longer than one Local Business Day, as noted in *c* above, and therefore a prior settlement may be incomplete before the next Valuation Date occurs, especially where Valuation Dates occur daily (on each Local Business Day).

In the case of the New York CSA, given, as noted in *c* above, that the settlement period is only one Local Business Day, the New York CSA does not need, and therefore does not provide, for such an adjustment.

e. ***Consent to Substitution of Collateral.*** The New York CSA permits parties to elect in Paragraph 13 that the Secured Party's consent is required before any substitution of collateral by the Pledgor. The Deed requires the consent of the Secured Party to be given to any substitution of collateral. This is to minimise the risk that the Deed may constitute a floating charge as a matter of English law.

A floating charge granted by an English company (or by a foreign company with a place of business in England or Wales in respect of collateral located in England or Wales) must be registered under the UK Companies Act 1985, as discussed elsewhere in this Guide. Failure to register a registrable charge within the relevant period (21 days after creation) results in the charge becoming void and the debt secured by it becoming repayable immediately (it is not clear how this latter effect would apply, however, in the case of an ISDA Master Agreement).

Even more seriously, a floating charge has a lower ranking on insolvency than a fixed charge, ranking behind certain statutorily preferred creditors and certain insolvency-related expenses. This lower ranking can, in some circumstances, result in the collateral being depleted before the holder of the floating charge is able to enforce against it. A floating charge is also vulnerable to avoidance under a special provision of the UK Insolvency Act 1986 (in addition to the usual provisions dealing with preferences, transactions at an undervalue and transactions defrauding creditors). Finally, a floating charge may not be effective against a counterparty organised or collateral located in a jurisdiction that does not recognise this form of security interest (and has no analogous form of security interest in its domestic law to which an English law floating charge could be assimilated).

Just as the Deed and the New York CSA differ, for the reasons discussed above, with regard to the timing of settlement of a Delivery Amount or Return Amount, the Deed and the New York CSA differ also in the timing of deliveries to effect a substitution.

f. ***Dispute Resolution.*** The Deed requires that any Disputing Party may only "reasonably" dispute a calculation of a Delivery Amount or a Return Amount or the value of a transfer. The New York CSA does not include this qualification.

There are also slight differences in timing and mechanics of notification and calculation between the Deed and the New York CSA.

Following a recalculation, the Valuation Agent in accordance with the terms of the Deed will notify each party "as soon as possible" but in any event not later than the Notification Time on the Local Business Day following the Resolution Time. The New York CSA does not provide for the "as soon as possible" requirement. The Deed also states that a failure by a party to make a

transfer of any amount which is the subject of a dispute will not constitute a Relevant Event while the procedures set out in the Deed are followed.

g. ***Using Posted Collateral.*** The New York CSA permits the Secured Party to use Posted Collateral. The Secured Party is able to sell, pledge, rehypothecate, assign, invest, use, commingle or otherwise dispose of, or otherwise use in its business any Posted Collateral it holds and to register any Posted Collateral in the name of the Secured Party, its Custodian or a nominee. With respect to Posted Collateral that the Secured Party does not so use, the Secured Party must exercise reasonable care to assure the safe custody of the collateral, and it will be deemed to have exercised such reasonable care if it exercises at least the same degree of care as it would exercise with respect to its own property.

The Deed does not allow for the use of the collateral. The Secured Party must exercise reasonable care to assure the safe custody of all Posted Collateral to the extent required by applicable law. Under English law a chargee is normally under a duty to preserve and take reasonable care of security assets under its care. Furthermore, the interest of the chargee is only a partial one. Ultimate ownership, in the form of an equity of redemption, remains in the chargor. Accordingly, it is inconsistent with the limited nature of a security interest that the holder of that security interest (the Secured Party, in the case of the Deed) should be able directly or indirectly to dispose of the full title to the collateral in any way, whether by outright sale, stock lending, securities repo, rehypothecation or in some other way.

h. ***Holding Posted Collateral.*** Under both the Deed and the New York CSA, the Secured Party is entitled to hold Posted Collateral or appoint a Custodian to hold the collateral. The Deed, however, places more stringent requirements on the Secured Party and any Custodian. Under the terms of the Deed, the Secured Party shall, and shall cause any Custodian to, open and maintain Segregated Accounts in which to hold collateral in the form of securities. The Secured Party and any Custodian must hold, record and/or identify in the relevant Segregated Accounts all Posted Collateral (other than cash) held in relation to the Chargor.

The Deed further provides that such collateral shall at all times remain the property of the Chargor and be segregated from and not commingled with the property of the Secured Party or the Custodian. The Deed further sets out the entitlements of the Chargor with respect to Distributions and voting rights arising with respect to the Posted Collateral and specifies that the Secured Party may exercise such rights in the event of a Relevant Event or Specified Condition occurring. The Chargor is obliged to pay all calls or other payments which become due in respect of the Posted Collateral. In default of such payment, the Secured Party may make such payments instead (in order to preserve the value of that collateral) and is entitled to recover interest on any such payment at the Default Rate.

The Chargor is required to provide all information required under section 212 of the UK Companies Act 1985 or under its articles of association or similar constitutional documents of any issuer of securities forming part of the Posted Collateral. Such provisions, which relate to equity shares, entitle the issuer of such equity shares, where it believes a person to have an interest in its equity shares with voting rights, to require that person to confirm its interest and to provide additional disclosure relating to its interest. If the Chargor fails to comply with such a requirement, the Secured Party may do so with such information as it has available.

There is a general disclaimer of any liability of the Secured Party in relation to Posted Collateral. For example, the Secured Party is not liable to perform any obligation of the Chargor with regard to Posted Collateral, to make any enquiry as to the nature or sufficiency of any payment it or the Chargor receives in relation to the Posted Collateral (for example, interest on debt securities held as collateral) or to make any claim or take any other action.

These are common provisions in an English law security agreement relating to securities. There are no directly comparable provisions in the New York CSA.

i. ***Distributions.*** The Deed provides that the Secured Party shall transfer any Distributions not later than the Settlement Day following each Distributions Date. The New York CSA provides that such Distributions shall be transferred on the Local Business Day following the Local Business Day such Distributions were received. This simply reflects the difference, discussed above, in settlement timing and mechanics between the two forms.

j. ***Governing Law and Jurisdiction.*** The Deed is stated to be governed by and construed in accordance with English law. The New York CSA supplements, forms part of and is subject to the ISDA Master Agreement and is therefore subject to the governing law of the ISDA Master Agreement, which may be either New York law or English law. As discussed in Part I of this Guide, not surprisingly the New York CSA is typically used with an ISDA Master Agreement governed by New York law.

k. ***Other Provisions.*** The rights and remedies granted the Secured Party in each of the Deed and the New York CSA reflect the nature, conditions and limitations of the security interest given under the relevant governing law.

The Deed provides for the irrevocable appointment of the Secured Party as the attorney of the Chargor on its behalf such that the attorney may do all acts and execute all documents which the Chargor could itself execute in relation to the Posted Collateral or matters provided for in the Deed. The Deed provides for the protection of a third party dealing with the Secured Party or its attorney and provides that the remedy of the Chargor in respect of any impropriety or irregularity whatever in the exercise of such powers shall be in damages only. These are, again, common provisions in an English law security agreement relating to securities. There are no directly comparable provisions in the New York CSA.

The Deed specifically includes "any stamp, transfer or similar transaction tax or duty payable on any transfer a party is required to make under this Deed" in the expenses provisions. The New York CSA does not include such a provision.

The New York CSA provides that all reasonable costs and expenses incurred by or on behalf of the Secured Party or the Pledgor in connection with the liquidation and/or application of any Posted Credit Support will be payable by the Defaulting Party or if there is no Defaulting Party equally by the parties. The Deed has a comparable provision, but limited to costs and expenses incurred by the Secured Party.

3. Conclusion. There are a number of differences between the New York CSA and the Deed, however virtually all of these relate to the differences in the laws underlying each document and the fact that the English law document contemplates a greater variety of types of collateral to be taken, in a number of currencies and in a more diverse range of possible markets. As far as possible, the Deed preserves the general approach, including the mark-to-market mechanics, of the New York CSA.

B. The Annex and the New York CSA

1. Key Similarities.

As in the case of the New York CSA, the Annex is an annex to the Schedule to the ISDA Master Agreement rather than a stand-alone document, as in the case of the Deed.

Each of the Annex and the New York CSA is intended to secure the net exposure arising under an ISDA Master Agreement, on the basis of the mark-to-market mechanics described in relation to the Annex in *Part I* of this Guide.

2. Key Differences.

a. ***No Security Interest.*** The most fundamental difference between the Annex and the New York CSA is that, in contrast to the New York CSA, the Annex does not create a security interest in the collateral transferred. Instead, the Annex creates a conditional contractual obligation, the value of which is determined by reference to the value of the collateral transferred. The collateral transferred, however, becomes the property of the collateral taker (the Transferee). The collateral provider (the Transferor) retains no proprietary interest in the assets transferred.

In other words, the collateral provider has no equity of redemption or any other form of proprietary interest in any collateral assets held by the collateral taker. Instead, as discussed in *Part I* of this Guide, the conditional contractual obligation (the Credit Support Balance) becomes an element in the close-out calculation under Section 6(e) of the related ISDA Master Agreement. The Annex relies on close-out netting for its effectiveness, not on enforcement of a security interest.

b. ***No Provision for Other Posted Support.*** The New York CSA (like the Deed) enables a Pledgor to provide credit support in the form of a letter of credit, guarantee or similar instrument. The Annex does not contemplate the use of Other Posted Support, although it can be amended, if necessary, to build in the necessary mechanics to allow such use.

c. ***Multicurrency Provisions.*** The Annex is a multicurrency form. The New York CSA is a single currency form. In other words, the Annex is intended to cover cash collateral and securities denominated in various currencies, while the New York CSA is intended to be used only with US Dollar cash and securities. For this reason there are specific provisions to convert all values to a Base Currency in the Annex, while such provisions are, of course, not included in the New York CSA.

This is important to bear in mind if considering use of the New York CSA with non-US Dollar collateral (for example, collateral denominated in Canadian Dollars or in an European or

Asian currency). In such a case, currency conversion mechanics would need to be added to the New York form.

d. ***Timing and Settlement Differences.*** The Annex contemplates taking securities located in various jurisdictions, while the New York CSA is intended primarily to be used with US Treasuries. In the Annex, as in the Deed, it was thought that more generic provisions relating to timing of deliveries and settlement mechanics were needed than are provided in the New York CSA.

Generally in the New York CSA, transfers are required to occur within one Local Business Day. In the Annex, transfers are required to occur as soon as practicable in accordance with custom and practice in the relevant market after receipt of a demand for a Delivery Amount or Return Amount, as the case may be, As noted above in relation to the Deed, this is to allow for differences in settlement timing and practice in different markets and settlement systems across Europe.

e. ***Credit Support Document.*** In contrast to the New York CSA, the Annex is not specified as a Credit Support Document for purposes of the related ISDA Master Agreement. The credit support arrangements set out in the Annex are instead stated to constitute a Transaction under the ISDA Master Agreement, in relation to which the Annex itself constitutes the relevant Confirmation. Accordingly, any default under the Annex constitutes a default under the related ISDA Master Agreement, without a need for the separate application of the Section 5(a)(iii) (Credit Support Default) of the ISDA Master Agreement.

f. ***Delivery Amount and Return Amount.*** In determining whether a Delivery Amount or a Return Amount is required to be made in relation to a Valuation Date, the Annex provides for an adjustment to the value of the Credit Support Balance on a Valuation Date to take account of any transfer of a prior Delivery Amount or Return Amount that is in course and has not yet fully settled as at that Valuation Date. This reflects the fact that a settlement period may last longer than one Local Business Day, as noted in *d* above, and therefore a prior settlement may be incomplete before the next Valuation Date occurs, especially where Valuation Dates occur daily (on each Local Business Day).

In the case of the New York CSA, given, as noted in *d* above, that the settlement period is only one Local Business Day, the New York CSA does not need, and therefore does not provide, for such an adjustment.

g. ***Exchanges and Substitutions.*** The New York CSA permits parties to elect in Paragraph 13 that the Secured Party's consent is required before any substitution of collateral by the Pledgor. The Annex requires the consent of the Transferee to be given to any exchange of collateral.

The New York CSA (like the Deed) uses the term "substitution", whereas the Annex uses the term "exchange", which was thought more appropriate for a title transfer based arrangement. Under the Annex there is no assumption that the Transferee is "holding" collateral, because any collateral taken by the Transferee is purchased outright by the Transferee under the Annex.

Accordingly, an exchange under the Annex is a sale of New Credit Support to the Transferee coupled with a sale of Equivalent Credit Support (representing the Original Credit Support) back to the Transferor. As each of the "legs" of the exchange is a sale, the fact that the Annex provides for the possibility of exchange has no bearing on the question of recharacterisation risk.

As noted above, the Annex provides that consent to each exchange must be obtained from the Transferee. In contrast to the Deed, however, the Annex is not a charge, and therefore the consent requirement is not necessary in order to avoid the Annex being characterised as a floating charge. The Annex may be amended so that the Transferee's consent to an exchange either may not be withheld or, at least, may not be withheld if certain conditions are met. Such an amendment would again have no bearing on the question of recharacterisation risk as it would not affect the nature of the exchange to which it relates.

Just as the Annex and the New York CSA differ, for the reasons discussed above, with regard to the timing of settlement of a Delivery Amount or Return Amount, the Annex and the New York CSA differ also in the timing of deliveries to effect an exchange.

h. ***Dispute Resolution.*** The Annex requires that any Disputing Party may only "reasonably" dispute a calculation of a Delivery Amount or a Return Amount or the value of a transfer. The New York CSA does not include this qualification.

There are also slight differences in timing and mechanics of notification and calculation between the Annex and the New York CSA.

Following a recalculation, the Valuation Agent in accordance with the terms of the Annex will notify each party "as soon as possible" but in any event not later than the Notification Time on the Local Business Day following the Resolution Time. The New York CSA does not provide for the "as soon as possible" requirement. The Annex also states that a failure by a party to make a transfer of any amount which is the subject of a dispute will not constitute an Event of Default while the procedures set out in the Annex are followed.

i. ***Holding of collateral.*** Given that under the Annex the collateral taker becomes the owner of any assets transferred to it, there are no provisions dealing with the holding of the collateral. Any such provisions would be incompatible with the nature of an outright sale.

In contrast, the New York CSA merely creates a security interest in the assets transferred, and therefore (subject to a general permission to deal with the assets) the Secured Party under the New York CSA owes certain duties in relation to the holding of the collateral assets, which remain, although subject to an encumbrance of the New York CSA, the property of the Pledgor.

j. ***Distributions.*** The Annex requires the Transferee to transfer to the Transferor Equivalent Distributions not later than the Settlement Day following each Distributions Date. The New York CSA requires the Secured Party to transfer Distributions on the Local Business Day following the Local Business Day on which it receives or is deemed to receive the Distributions. This simply reflects the difference, discussed above, in settlement timing and mechanics between the two forms.

k. ***Other Provisions.*** The Annex specifically includes "any stamp, transfer or similar transaction tax or duty payable on any transfer a party is required to make under this Annex" in the expenses provisions. The New York CSA does not include such a provision.

The New York CSA obliges the Pledgor to execute, deliver, file and record any financing statement, specific assignment or other document or take other reasonable action in order to create, preserve, perfect or validate any security interest or lien and to enable the Secured Party to enforce or exercise its rights. The Pledgor is also obliged to give notice of and to defend against any suit, action, proceeding or lien that involves the collateral. There are no such requirements and obligations included in the Annex. Such provisions are unnecessary given that the collateral taker becomes the full legal owner of the relevant assets at the time of transfer.

3. Conclusion. The fundamental difference between the Annex and the New York CSA is that the Annex relies on the title transfer approach and therefore ultimately on the close-out netting provisions of the related ISDA Master Agreement. In contrast, the New York CSA creates a security interest in the collateral transferred.

Both forms have the advantage of allowing the collateral taker to deal freely with collateral taken, although the legal basis for such use of the collateral differs.

Relative to the New York CSA, the Annex, like the Deed, contemplates a greater variety of types of collateral to be taken, in a number of currencies and in a more diverse range of possible markets. As far as possible, however, the Annex preserves the general commercial effect, in particular the mark-to-market mechanics, of the New York CSA.

APPENDIX A

FORM OF AMENDMENT TO ISDA MASTER AGREEMENT TO ADD THE 1995 ISDA CREDIT SUPPORT ANNEX (TRANSFER)[1]

Parties should consult with their legal advisers and any other adviser they deem appropriate prior to using this form of Amendment. Because of the varied documentation structures in the marketplace, modifications to this form of Amendment may be necessary or an entirely different form of amendment may be appropriate.

AMENDMENT TO ISDA MASTER AGREEMENT

dated as of .....

..... and .....

have entered into an ISDA Master Agreement dated as of ....., as amended and supplemented from time to time (the "Agreement").

The parties have agreed to amend the Agreement as follows:

1. Amendment of the Agreement

Upon execution of this Amendment by both parties, the Agreement is amended to add as part of the Schedule to the Agreement the 1995 ISDA Credit Support Annex (Transfer) (the "Annex") in the form set out in the Exhibit attached to this Amendment.

2. Representations

Each party represents to the other party that all representations contained in the Agreement (including all representations set out in the Annex) are true and accurate as of the date of this Amendment and that such representations are deemed to be given or repeated, as the case may be, by each party on the date of this Amendment.

3. Miscellaneous

(a) **Definitions.** Capitalised terms used in this Amendment and not otherwise defined shall have the meanings specified for such terms in the Agreement.

(b) **Entire Agreement.** This Amendment constitutes the entire agreement and understanding of the parties with respect to its subject matter and supersedes all oral communication and prior writings (except as otherwise provided in this Amendment) with respect to its subject matter.

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1 As the Deed is a stand-alone document, it is not necessary to amend the related ISDA Master Agreement in order to put it in place.

(c) **Counterparts.** This Amendment may be executed and delivered in counterparts (including by facsimile transmission), each of which will be deemed an original.

(d) **Headings.** The headings used in this Amendment are for convenience of reference only and are not to affect the construction of or to be taken into consideration in interpreting this Amendment.

(e) **Governing Law.** This Amendment will be governed by and construed in accordance with English law/the laws of the State of New York (without reference to choice of law doctrine).[2]

IN WITNESS WHEREOF the parties have executed this Amendment on the respective dates specified below with effect from the date specified on the first page of this Amendment.

.....	.....
(Name of Party)	(Name of Party)
By:.....	By .....
Name:	Name:
Title:	Title:
Date:	Date:

[2] Delete as applicable

MODIFICATIONS TO ELIMINATE OFFSET OF INDEPENDENT AMOUNTS

The Deed

Some parties may wish to (a) modify the Credit Support Amount formula in the Deed to eliminate the subtraction of Independent Amounts applicable to the Secured Party from the calculation of Credit Support Amount and (b) add a provision to Paragraph 3 (Credit Support Obligations) of the Deed that prohibits offset. These amendments would allow both parties to the Deed to be fully secured both with respect to their Exposure and in connection with any Independent Amounts applicable to their counterparty.

This approach may result in each party's holding Posted Credit Support as a Secured Party simultaneously. For example, one party may hold Posted Credit Support as security for the Independent Amounts applicable to the other party and the other party may hold Posted Credit Support because its Exposure to the first party has given rise to a demand for a Delivery Amount. Parties wishing to achieve this result should add the following provisions to Paragraph 13 (under subparagraphs (c) and (1), as appropriate) of the Deed:

> **"Credit Support Amount"** means, for any Valuation Date (i) the Secured Party's Exposure for that Valuation Date plus (ii) the aggregate of all Independent Amounts applicable to the Chargor, if any, minus (iii) the Chargor's Threshold; provided, however, that (x) in the case where the sum of the Independent Amounts applicable to the Chargor exceeds zero, the Credit Support Amount will not be less than the sum of all Independent Amounts applicable to the Chargor and (y) in all other cases, the Credit Support Amount will be deemed to be zero whenever the calculation of Credit Support Amount yields an amount less than zero.
>
> **Additions to Paragraph 3.** The following subparagraph (c) is hereby added to Paragraph 3 of this Deed:
>
> (c) **No offset.** On any Valuation Date, if either (i) each party is required to make a transfer under Paragraph 3(a) or (ii) each party is required to make a transfer under Paragraph 3(b), then the amounts of those obligations will not offset each other.

The prohibition against offset contained in Paragraph 3(c) is intended to clarify that a credit support obligation in favour of a party, as Secured Party, is not to be offset against a credit support obligation arising in connection with an Independent Amount applicable to that same party, as Chargor. The following example illustrates this prohibition against offset:

> If on or promptly following a Valuation Date:
>
> (i) Party A transfers $10 to Party B in connection with an Independent Amount applicable to it as a Chargor; and
>
> (ii) Party B transfers $50 to Party A pursuant to the amount of Party A's Exposure; and
>
> on a subsequent Valuation Date:
>
> (iii) the Value of Posted Credit Support held by Party B has decreased to $9; and
>
> (iv) the Exposure of Party A has increased to $70; then,

if the offset of these obligations:

(a) were permitted, there would exist only one credit support obligation of Party B to transfer $19 to Party A (thereby leaving each of Party A and Party B undersecured by $1); or

(b) were not permitted, there would exist one credit support obligation of Party B to transfer $20 to Party A and one credit support obligation of Party A to transfer $1 to Party B (thereby leaving each of Party A and Party B fully secured).

The Annex

For the reasons given above, parties to the Annex may wish to make the same amendments as those referred to above (adjusted to reflect the terminology and numbering of the Annex) to the definition of Credit Support Amount and to Paragraph 2 (Credit Support Obligations).

APPENDIX C

EXAMPLE OF USES OF MINIMUM TRANSFER AMOUNT AND THE ROUNDING VARIABLE

The following examples demonstrate the use of "Minimum Transfer Amount" and the rounding variable under the Deed (and, by analogy, to the comparable provisions of the Annex):

Minimum Transfer Amount

The Minimum Transfer Amount for Party A and Party B may be set as follows (with a specification that the Minimum Transfer Amount applicable to either party on any particular day will be as indicated opposite the lowest (or highest) of the ratings indicated):

Using this credit ratings approach for "Minimum Transfer Amount", parties are able to vary the amount of Eligible Credit Support required to be delivered by a party depending upon the credit rating of that party. Once the Minimum Transfer Amount applicable to a party at a particular ratings level is reached, that party is obliged to deliver the full amount of Eligible Credit Support required.

Senior Unsecured Debt Ratings		**Minimum Transfer Amount**
Moody's Investors Services, Inc.	**Standard & Poor's Corporation**	
[Rating]	[Rating]	[$]

Because the use of a Minimum Transfer Amount only establishes a "floor", it does not eliminate the possibility that parties will be required to deliver uneven amounts of Eligible Collateral or Posted Collateral. As discussed in the next section, parties must establish a rounding convention to eliminate such requirements. Additionally, as discussed below, parties can use rounding as a substitute for a Minimum Transfer Amount.

Rounding

Market participants may use a rounding convention as an alternative to a Minimum Transfer Amount. For example, the parties could specify that (i) Delivery Amounts and Return Amounts below a specified level would be rounded down to zero and (ii) Delivery Amounts above that level would be rounded up and Return Amounts above that level would be rounded down, in each case to the nearest integral multiple specified by the parties. (As discussed in *Part II* of this Guide, parties would not ordinarily be expected to specify that both Delivery Amounts and Return amounts are to be rounded up, as this could create conflicting obligations to transfer collateral and result in a Secured Party being undersecured.) In this way, market participants obtain the same "minimum" that using a Minimum Transfer Amount would provide, but avoid having to specify a separate rounding convention to eliminate uneven Delivery Amounts or Return Amounts.

Assume that each party is willing to be unsecured for up to $10 of Exposure (or additional Exposure above the amount of Posted Credit Support held by the Secured Party) and to allow the other party to be oversecured for the first $10 of any decline in Exposure, but that each party wishes to round all Delivery Amounts above that level up to the nearest $5 and round all Return Amounts above that level down to the nearest $5.

Parties may achieve this result by completing the rounding variable in Paragraph 13(c)(iii)(D) of the Deed as follows:

> **Delivery Amount and Return Amount:** (a) all Delivery Amounts and Return Amounts that are less than $10 will be rounded down to zero, (b) all Delivery Amounts above $10 will be rounded up to the nearest multiple of $5 and (c) all Return Amounts above $10 will be rounded down to the nearest multiple of $5.

Unlike using the Minimum Transfer Amount alternative, which may result in calls for Eligible Credit Support or Posted Credit Support in amounts of $10, $11, $12 and so on, the rounding convention results in movements only in specified bands or ranges, thus simplifying the collateralisation process operationally.

EXECUTION OF A DEED

Parties should note that this appendix only sets out the requirements for the execution of a deed under English law as at the date of publication of this Guide (March 1999). There may be additional requirements under the laws of other relevant jurisdictions, such as the jurisdiction where a counterparty is incorporated, and/or under a party's constitutional documents. Parties should seek legal guidance as appropriate.

1. General

As noted in *Part I* of this Guide, in order to give effect to the power of sale and other statutory powers contained in section 101 of the UK Law of Property Act 1925, and to permit the Secured Party, as attorney under the power of attorney included in the Deed, to execute further documents as deeds (where necessary) on behalf of the Chargor for the benefit of the Secured Party, the Credit Support Deed must be executed as a deed.

If the deed is executed by one party with a counterpart being executed by the other party, wording should be included to the effect that the two parts constitute a single document. Appropriate wording could be:

> "This agreement may be executed in any number of counterparts, all of which, taken together, shall constitute one and the same agreement, and any party may enter into this agreement by executing a counterpart".

To be validly executed as a deed, the document must make clear on its face that it is intended to be a deed. This requirement is satisfied, in the case of the ISDA Credit Support Deed, by the title of the document and by the wording of the signature page.

2. Execution by a company incorporated in England and Wales under the Companies Acts

A deed is validly executed as a deed by a company incorporated in England and Wales under the Companies Acts if it is either:

(a) executed by the company under its seal; or

(b) signed by a director and the secretary of the company or by two directors and expressed to be executed by the company.

The deed will take effect upon delivery. In some cases, the deed will be deemed to be delivered upon execution, but, even where it is not, there is a rebuttable presumption that the deed will have been delivered upon execution. A deed may be executed through an attorney (or, in US terminology, an "attorney-in-fact", that is, the person on whom certain powers and responsibilities are conferred by the power of attorney), but that attorney's authority must be conferred by deed. The attorney may be an individual, company or other entity. Legal advice should be taken if the company is in liquidation, receivership or administration, if it is a Scottish company, or if it is a company incorporated in England and Wales but not under the Companies Acts.

3. Execution by a company other than a company incorporated in England, Wales or Scotland

A company other than a company incorporated in England, Wales or Scotland may validly execute a document as a deed by:

(a) affixing its common seal (if it has one);

(b) executing the document in any manner permitted by the laws of the country of incorporation of the company for the execution of documents by such a company; or

(c) having the document signed by a person or persons who, in accordance with the laws of the company's country of incorporation, is or are acting under the express or implied authority of that company and having the document expressed, in whatever form of words, to be executed by the company.

A deed may also be executed through an attorney. In such a case, the attorney's authority must be conferred by a deed executed in one of the above three ways. The attorney may be an individual, company or other entity.

Except where the deed is being executed through an attorney, the authority to execute a deed on behalf of a company incorporated outside England, Wales and Scotland does not have to be given by deed, unless that is a requirement of the laws of the country of incorporation. If the signatory is not authorised by deed, care should be taken not to describe the signatory as an "attorney".

The deed will take effect upon delivery. There is a rebuttable presumption that the deed will have been delivered upon execution.