

## Key Changes in the 2002 ISDA Master Agreement

### *New measure of damages provision: Close-out Amount.*

Market Quotation and Loss, the standards in the 1992 ISDA Master Agreement, have been replaced by a single standard, Close-out Amount. The new approach to closing-out transactions is based on a standard of commercial reasonableness and describes the type of information that can be used in valuing terminated transactions and sets forth the procedures that can be followed in valuing those terminated transactions.

### *Introduction of Force Majeure Termination Event.*

Force Majeure Termination Event was added as a new Termination Event in the 2002 ISDA Master Agreement. A force majeure provision was not included in the 1992 ISDA Master Agreement, as there was not member consensus on the need for such a provision at that time. The new provision is intended to ensure that force majeure events such as natural or man-made disasters, labor riots, acts of terrorism and other unanticipated events that prevent the performance of a party's obligations under the contract are considered. Once such an event occurs, a party is obligated to show that the event is beyond its control and that it could not overcome the event by using all reasonable efforts and that a waiting period of eight Local Business Days has expired. At that point, a party may move to terminate the transactions affected by the event.

### *Reduction of Grace Periods*

Grace periods in Bankruptcy and Default Under Specified Transaction and Bankruptcy were reduced. For example, if a party failed to make a payment under the 1992 ISDA Master Agreement, notice of such failure was provided and the party was given a grace period of three Local Business Days to remedy its failure. Under the 2002 ISDA Master Agreement, the three Local Business Day grace period has been reduced to one Local Business Day. A similar change was made for the grace period in Default Under Specified Transaction. The Bankruptcy Event of Default in the 1992 ISDA Master Agreement provided for a 30 calendar day period during which the bankrupt party could attempt to have the bankruptcy petition dismissed or stayed before an Event of Default was triggered. The new provision distinguishes between proceedings started by a party or its principal regulator, which become an Event of Default immediately, and proceedings started by third parties, which become an Event of Default after 15 calendar days.

### *Inclusion of Set-off Provision*

The 1992 ISDA Master Agreement did not include a set-off provision. Set-off provisions are important in default situations because they allow the non-defaulting party to attempt to garner assets of the defaulting party other than the amounts it is owed. Thus, with a set-off provision, the non-defaulting party can explore whether there are other assets such as a deposit account that can be attached and then set-off against the amount the defaulting party owes the non-defaulting party.

## Key Changes in the 2002 ISDA Equity Derivatives Definitions

### *New product coverage.*

The 2002 ISDA Equity Derivatives Definitions expand the product coverage offered in the 1996 ISDA Equity Derivatives Definitions. New products include barrier instruments, Bermuda options and forwards. Forwards and barrier instruments, in particular, have significantly increased in importance among participants in these products.

### *Amendments to definition of Business Days.*

Disruptions on September 11, 2001 to the U.S. stock exchange and consequent issues in how equities were to be valued led to member demand for amending the definition of what constitutes a “good” Exchange Business Day. Now, if an equity market opens for even a minute, this will constitute an Exchange Business Day. The definition of Scheduled Trading Day has also been provided, reflecting the fact that exchanges’ schedules may change from time-to-time, but market participants do not want this event to be treated as a market disruption. The definition of Currency Business Day was amended to reflect the existence of the TARGET calendar associated with the euro.

### *Disruptions.*

The determination of what constitutes a Business Day is important in deciding whether a disruption has occurred. Refinements to the disruption provisions are offered in the new Definitions. The failure to open an exchange or the occurrence of a market disruption event are primary considerations. Market disruption events in the new Definitions relate to the occurrence of a trading disruption, an exchange disruption or an early closing of the exchange.

### *Consequences of Disruptions.*

If a disruption occurs, the prescribed valuation procedure for the affected equities cannot be followed. The new Definitions provide that valuation under these circumstances can be delayed for up to eight Business Days after the originally scheduled valuation date and, at the end of this period, the Calculation Agent will determine the appropriate valuation approach.

### *Merger Events.*

One of the primary initiatives in publishing the new Definitions was to amend the menu of consequences available to parties when a merger event occurs. Merger events and other such extraordinary occurrences will result in the stock underlying the equity derivative transaction disappearing or assuming an economically different value. Thus, the options available to parties have been expanded in order to offer more customized provisions. In addition, tender offers are also addressed in the new Definitions. Tender offers were not as common in 1996, but in the intervening years have become more standard. Thus, the new Definitions define a tender offer as an offer for more than ten percent, but less than 100 percent of the outstanding shares of a company.