## Memorandum

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**Eurozone Exit - ISDA Documentation Considerations**

**2006 ISDA Definitions**

As part of ISDA's continuing discussions with its members in relation to the Eurozone crisis, and in particular ISDA's Eurozone Contingency Discussion Group, ISDA has arranged for a number of product specific papers to be produced to assist members in their Eurozone contingency planning in the event that an EU member state were to exit from the Eurozone (the "**Departing State**"). The papers highlight various issues that may arise as a result of redenomination legislation, capital and exchange controls and unscheduled bank holidays in relation to a Departing State.

This paper discusses the 2006 ISDA Definitions (the "**ISDA Definitions**").

One of the challenges in analysing the effects of a Eurozone exit is that there is no legal mechanism for such an exit in existing EU legislation. It is not clear to what extent such an exit would be consensual or unilateral, or would or would not be supported by EU legislation. For the purposes of the analysis in this paper, however, the following assumptions have been made:

(a)     the Departing State passes a law (the "**New Currency Law**") redenominating all obligations owed by and to it from the Euro into a new currency (the "**New Currency**");

(b)     the Departing state exits without EU consensus and over-arching EU legislation recognising the redenomination of debts effected by the Departing State's New Currency Law;

(c)     the Departing state introduces new capital and exchange controls; and

(d)     the Departing state designates additional bank holidays for the purposes of accommodating the redenomination.

*Parties should note that this guidance relates to transactions under an ISDA Master Agreement in relation to which the 2006 Definitions have been incorporated. To the extent transactions have incorporated different or additional definitions different issues and a different analysis may apply.*

**Executive Summary**

- Additional bank holidays designated by a Departing State may cause a day not to be a Business Day for the purposes of a transaction if a Confirmation specifies a place in the Departing State as a Business Day, or Euro payments/determinations are to be made and the TARGET2 system is not open.

- Settlement Rate Options for deposits in Euros are determined on a T+2 basis (rates for a deposit in two TARGET Settlement Days time). To the extent a Reset Date moves because of an additional bank holiday that is not also a day on which TARGET2 is closed, the previously determined rate may not be applicable.

- EURIBOR is determined by a panel of banks selected by the European Money Markets Institute (the "**EMMI**") and EUR-LIBOR-BBA is determined by a panel of banks selected by the ICE Benchmark Association (the "**IBA**"). To the extent that not all the panel banks are able to provide data for deposits in Euros the rates will be determined by the data provided by the remaining panel banks, in accordance with the rules set out by the EMMI or IBA, as applicable.

  In each case the ultimate fallback is for the Calculation Agent to obtain rates from Reference Banks. The Reference Banks are selected by the Calculation Agent but differ depending on the Settlement Rate Option being determined.

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**Suggested Actions for ISDA Members**

- Determine the interest rate swap transactions that have been entered into with parties located in a potential Departing State.

- Review the Confirmations to consider whether any additions or amendments to the Business Days used in the transactions cause Business Days to be linked to local Business Days in the Departing State.

- Determine whether the rate fixing day has been or would be affected by any unscheduled bank holidays in the Departing State.

- Consider any potential mis-matches where interest rate swap transactions are hedging other interest rate obligations.

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1.    **ISSUES RELATING TO BUSINESS DAYS**

1.1    **Business Day**

1.1.1    Summary

Parties should identify confirmations that specify places in a Departing State for the purposes of determining "Business Days" or "Banking Days". Additional bank holidays designated by a Departing State may cause such days not to be Business/Banking Days.

1.1.2    Issues relating to Business Days

Relevant days specified in a confirmation will be Business Days in the places specified if on such day in such places commercial banks and foreign exchange markets settle payments and are open for general business (including dealings in foreign exchange and foreign currency deposits).

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**SETTLEMENT DATE**

*""**Business Day**" means, in respect of any date that is specified in these 2006 Definitions or in a Confirmation to be subject to adjustment in accordance with any applicable Business Day Convention, a day on which commercial banks and foreign exchange markets settle payments and are open for general business (including dealings in foreign exchange and foreign currency deposits) in the place(s) and on the days specified for that purpose in the related Confirmation, a TARGET Settlement Day (if "TARGET" or "TARGET Settlement Day" is specified for that purpose in the related Confirmation)…and, if place(s) and days, or such terms, are not so specified, a day:…*

*(b)        that is a TARGET Settlement Day, if the currency of the payment obligation that is payable on or calculated by reference to that date is the euro'…*

*"**Euro**", "**euro**", "**€**" and "**EUR**" each means the lawful currency of the member states of the European Union that adopt the single currency in accordance with the EC Treaty.*

*"**TARGET Settlement Day**" means any day on which TARGET2 (the Trans-European Automated Real-time Gross Settlement Express Transfer system) is open for the settlement of payments in Euro.*[1]

*"**EC Treat**y" means the Treaty establishing the European Community (signed in Rome on March 25, 1957), as amended by the Treaty on European Union (signed in Maastricht on February 7,1992), the Treaty of Amsterdam (signed in Amsterdam on October 2, 1997) and the Treaty of Nice (signed in Nice on February 26,2001).*

*Extracts from Article 1 of the ISDA Definitions*

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Any additional bank holidays designated by a Departing State will inevitably result in the closure of commercial banks and foreign exchange markets.

Accordingly, confirmations that specify places in a Departing State that would be affected by the additional bank holidays will cause days which would otherwise be Business Days, not to be Business Days. The Business Day Convention specified in the relevant confirmation will then apply to move the due date for the right/obligation/determination to a Business Day.

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[1]    The 2006 Definitions were updated for the introduction of TARGET2 through Supplement number 6 to the 2006 ISDA Definitions (published on June 9, 2008).

If no Business Days are specified in the confirmation, for payments in Euro or determinations made by reference to Euro, a Business Day must be a TARGET Settlement Day (being a day on which TARGET2 is "open").

Similarly, if places are specified for the purposes of determining Banking Days in the confirmation, to the extent an additional bank holiday would cause commercial banks to be closed for general business in such places, the relevant day applicable to the right/obligations/determination will move to a Business Day in accordance with the Business Day Convention specified in the Confirmation.

*What does it mean for TARGET2 to be "open"?*

Whether or not TARGET2 will be open on the additional bank holidays may be a matter of interpretation given the developments connected with the Eurozone exit and may be a matter on which market participants would seek clarification from the ECB and/or come to an agreed position.

In general, the opening of TARGET2 is not linked to the Bank Holidays of any individual member states (TARGET2 is closed on weekends, New Year's Day, Good Friday, Easter Monday, 1 May, Christmas Day, and Boxing Day). The original TARGET system linked individual existing national gross settlement systems; TARGET has since been replaced by TARGET2, an EU wide system to which each of the national gross settlement systems connect. If a national gross settlement system was not connected to the TARGET2 system on a given day, there may be an argument that TARGET2 is not "open". It is also possible that the ECB may take other actions in relation to TARGET2 which could affect the position.

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**BANKING DAY**

*"Banking Day" means, in respect of any city, any day on which commercial banks are open for general business (including dealings in foreign exchange and foreign currency deposits) in that city.*

*Article 1 of the ISDA Definitions*

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The definitions for Banking Day and Business Day differ slightly ("any day on which commercial banks are open for general business" in the definition of Banking Day, and "a day on which commercial banks and foreign exchange markets settle payments and are open for general business" in the definition of Business Day); however, we would not expect this difference to affect the analysis of the effect of any additional bank holiday introduced by a Departing State.

2.      **ISSUES TO CONSIDER IN RELATION TO INTEREST RATES**

2.1     **Settlement Rate Options**

2.1.1   Summary

It will be important to determine whether or not the Reset Date will be affected by additional bank holidays as this will affect the day on which the rates for deposits will be determined.

As the rates for deposits in Euros are determined on a T+2 TARGET Settlement Days basis, if any of the scheduled TARGET Settlement Days prior to the Reset Date are not TARGET Settlement Days, consideration will need to be given as to which is the appropriate date on which the Calculation Agent should obtain rates.

Each of EURIBOR and EUR-LIBOR have a large number of panel banks, so it is unlikely that the failure of a small number of panel banks to provide data (e.g. Greek panel banks (only National Bank of Greece is on the EMMI panel for EURIBOR)) would cause the relevant screen rates not to be published.

2.1.2   Issues relating to Interest Rate Options

The interbank offering rates for deposits in Euros are provided on a T+2 basis (ie two TARGET Settlement Days preceding the relevant Reset Date). Provided sufficient panel banks are open and are providing rates data to the relevant rate fixing institutions, in accordance with the applicable rate fixing rules, the rates should be published in the normal manner, notwithstanding additional bank holidays designated by a Departing State.

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**RESET DATE**

*"Reset Date" means, for a Swap Transaction or a party:*

*(i)        if ""Arrears Setting"" is specified...; or*

*(ii)       otherwise, each day specified as such (or determined pursuant to a method specified for such purpose) for the Swap Transaction or that party, subject to adjustment in accordance with any applicable Business Day Convention which, if a Business Day Convention is not specified in the related Confirmation as being applicable to Reset Dates, shall be the Business Day Convention applicable to Floating Rate Payer Payment Dates in respect of that Swap Transaction, unless an adjustment in accordance with that Business Day Convention would cause a Reset Date to fall on the Payment Date in respect of the Calculation Period to which that Reset Date relates, in which case that Reset Date shall be adjusted in accordance with the Preceding Business Day Convention.*

*Section 6.2 of the ISDA Definitions*

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If there is an unscheduled bank holiday this may disrupt the manner in which rates have been determined. Take the example where a rate is to be obtained on Thursday for deposits being made on a Reset Date to occur on the following Monday. If, as a result of an additional bank holiday, the terms of the confirmation require the Reset Date to be adjusted (for example to the

Tuesday), the rate determined on Thursday is no longer the date falling two TARGET Settlement Days prior to the Reset Date. The second TARGET Settlement Day prior to the Reset Date would be Friday.

*How is EURIBOR determined?*

A Settlement Rate Option that is determined by reference to a EURIBOR rate (i.e. EUR-EURIBOR-Reuters, EUR-EURIBOR Actual 365, EUR-Annual Swap Rate-Reference Banks), is published from data provided by the EURIBOR panel banks (of which there are currently 24[2]) selected by the European Money Markets Institute. The European Money Markets Institute's EURIBOR Code of Conduct requires the panel banks to quote Euro rates that are "to the best of [the panel bank's] knowledge…rates at which Euro interbank term deposits are being offered within the EMU zone by one prime bank to another at 11.00 a.m. Brussels time"[3].

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**EUR-EURIBOR-REUTERS**

*"EUR-EURIBOR-Reuters" means that the rate for a Reset Date will be the rate for deposits in euros for a period of the Designated Maturity which appears on the Reuters Screen EURIBOR01 Page as of 11:00 a.m., Brussels time, on the day that is two TARGET Settlement Days preceding that Reset Date. If such rate does not appear on the Reuters Screen EURIBOR01 Page, the rate for that Reset Date will be determined as if the parties had specified "EUR-EURIBOR-Reference Banks" as the applicable Floating Rate Option.*

*Section 7.1(f) of the ISDA Definitions*

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If more than 50% of panel banks fail to provide their data by 11.00 a.m. Brussels time, the publication of the rate shall be delayed until 50% of panel banks have quoted. If that is not possible before 11.15 a.m.:

(i)     if 12 or more panel banks from 3 or more countries have provided data, Euribor shall be based on that data; and

(ii)    if fewer than 12 panel banks have provided data or if the panel banks which have provided data are from fewer than 3 countries, the

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[2]    Belgium: Belfius
       Finland: Nordea, Pohjola
       France: BNP-Paribas, HSBC France, Natixis, Crédit Agricole s.a., Société Générale
       Germany: Deutsche Bank, DZ Bank
       Greece: National Bank of Greece
       Italy: Intesa Sanpaolo, Monte dei Paschi di Siena, UniCredit
       Luxembourg: Banque et Caisse d'Épargne de l'État
       Netherlands: ING Bank
       Portugal: Caixa Geral De Depósitos (CGD)
       Spain: Banco Bilbao Vizcaya Argentaria, Banco Santander, CECABANK, CaixaBank S.A.
       Other EU Banks: Barclays Capital
       International Banks: London Branch of JP Morgan Chase Bank N.A., Bank of Tokyo Mitsubishi

[3]    http://www.emmi-benchmarks.eu/assets/files/Euribor_code_conduct.pdf

publication of the rate shall be delayed for that day until 12 or more panel banks from 3 or more countries have provided data.[4]

Accordingly if 12 out of the 24 panel banks are able to provide dates for EURIBOR rates, the EURIBOR rates should be published on the relevant screen page.

*What is the EURIBOR fallback?*

If EURIBOR is not published, the fallback Settlement Rate Option is "EUR-EURIBOR Reference Banks". The rate for a Reset Date will be determined on the basis of the rates at which deposits in Euros are offered by the Reference Banks at approximately 11:00 a.m., Brussels time, on the day that is two TARGET Settlement Days preceding that Reset Date to prime banks in the Euro-zone interbank market.

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**REFERENCE BANKS**

*"EUR-EURIBOR- Reference Banks"* *means that the rate for a Reset Date will be determined on the basis of the rates at which deposits in euros are offered by the Reference Banks at approximately 11:00 a.m., Brussels time, on the day that is two TARGET Settlement Days preceding that Reset Date to prime banks in the Euro-zone interbank market for a period of the Designated Maturity commencing on that Reset Date and in a Representative Amount (A) in the case of "EUR-EURIBOR-Reuters", assuming an Actual/360 day count basis, or (B) in the case of "EUR-EURIBOR-Act/365" and "EUR-EURIBOR-ACT/365 -Bloomberg", assuming an Actual/365 (Fixed) day count basis. The Calculation Agent will request the principal Euro-zone office of each of the Reference Banks to provide a quotation of its rate. If at least two quotations are provided, the rate for that Reset Date will be the arithmetic mean of the quotations. If fewer than two quotations are provided as requested, the rate for that Reset Date will be the arithmetic mean of the rates quoted by major banks in the Euro-zone, selected by the Calculation Agent, at approximately 11:00 a.m., Brussels time, on that Reset Date for loans in euros to leading European banks for a period of the Designated Maturity commencing on that Reset Date and in a Representative Amount.*

*Section 7.1(f) of the ISDA Definitions*

*"Reference Banks"* *means:...*

*(iv)      for purposes of any "LIBOR" Floating Rate Option, four major banks in the London interbank market;...*

*(vii)     for purposes of any "EURIBOR" Floating Rate Option, four major banks in the Euro-zone interbank market;...*

*(viii)    for purposes of any "EUR-Annual Swap Rate" Floating Rate Option, five leading swap dealers in the interbank market;*

*Section 7.3(c) of the ISDA Definitions*

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The Reference Banks for the purposes of any EURIBOR Settlement Rate Option are four major banks in the Euro-zone interbank market. The Calculation Agent will be required to select such banks "in good faith after consultation with the other party (or the parties, if the Calculation Agent is a third party), if practicable, for purposes of obtaining a representative rate that will reasonably reflect conditions prevailing at the time in the relevant market".

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[4]    http://www.emmi-benchmarks.eu/assets/files/Euribor_tech_features.pdf

> **CALCULATION AGENT**
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> *"Calculation Agent" means the party to a Swap Transaction (or a third party) designated as such for the Swap Transaction and responsible for (a) calculating the applicable Floating Rate, if any, for each Payment Date or for each Calculation Period or Compounding Period...Whenever the Calculation Agent is required to select banks or dealers for purposes of making any calculation or determination or to select any exchange rate, the Calculation Agent will make the selection in good faith after consultation with the other party (or the parties, if the Calculation Agent is a third party), if practicable, for purposes of obtaining a representative rate that will reasonably reflect conditions prevailing at the time in the relevant market or designating a freely convertible currency, as the case may be. Whenever the Calculation Agent is required to act, make a determination or to exercise judgment in any other way, it will do so in good faith and in a commercially reasonable manner.*
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> *Section 4.14 of the ISDA Definitions*

If fewer than two quotations are provided by Reference Banks selected by the Calculation Agent, the rate will be the arithmetic mean of the rates quoted by major banks in the Euro-zone, selected by the Calculation Agent, at approximately 11:00 a.m., Brussels time, on that Reset Date for loans in Euros to leading European banks for a period of the Designated Maturity commencing on that Reset Date and in a Representative Amount.

It is worth noting that the Reference Banks fallback does not ultimately provide for Calculation Agent determination, which is the case in the Reference Bank fallbacks for more illiquid currencies (e.g. Mexican Peso, Russian Rubles).

*How is EUR-LIBOR determined?*

The Settlement Rate Options for Euros determined by LIBOR are set by the BBA LIBOR panel for Euros[5]. Each bank on the panel is asked to provide the rate at which they could borrow funds by asking for and accepting inter-bank offers in a reasonable market size. The rates submitted by each of the panel banks (submitted between 11 a.m. and 11.10 a.m. London time) are then arithmetically averaged after removing a certain number of highest and lowest submissions (depending on the total number of submissions)[6]. The minimum number of submissions referred to on the BBA LIBOR website is five.

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[5]  As of November 2011: Abbey National plc, Bank of Tokyo-Mitsubishi UFJ Ltd, Barclays Bank plc, Citibank NA, Credit Suisse, Deutsche Bank AG, HSBC, JP Morgan Chase, Lloyds Banking Group, Mizuho Corporate Bank, Rabobank , Royal Bank of Canada , Société Générale, The Royal Bank of Scotland Group, UBS AG

[6]  http://www.bbalibor.com/bbalibor-explained/the-basics

> **EUR-LIBOR-BBA**
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> *"EUR-LIBOR-BBA" means that the rate for a Reset Date will be the rate for deposits in euros for a period of the Designated Maturity which appears on the Reuters Screen LIBOR01 Page as of 11:00 a.m., London time, on the day that is two TARGET Settlement Days preceding that Reset Date. If such rate does not appear on the Reuters Screen LIBOR01 Page, the rate for that Reset Date will be determined as if the parties had specified "EUR-LIBOR-Reference Banks" as the applicable Floating Rate Option.*
>
> *Section 7.1(f) of the ISDA Definitions*

*What is the EUR-LIBOR fallback?*

If a EUR-LIBOR-BBA is not published the rate will fall back to a rate determined on the basis of rates on deposits in Euros offered by the Reference Banks at approximately 11:00 a.m., London time, on the day that is two TARGET Settlement Days preceding that Reset Date to prime banks in the London interbank market for a period of the Designated Maturity and in a Representative Amount.

> **EUR-LIBOR-REFERENCE BANKS**
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> *"EUR-LIBOR-Reference Banks" means that the rate for a Reset Date will be determined on the basis of the rates at which deposits in euros are offered by the Reference Banks at approximately 11:00 a.m., London time, on the day that is two TARGET Settlement Days preceding that Reset Date to prime banks in the London interbank market for a period of the Designated Maturity commencing on that Reset Date and in a Representative Amount. The Calculation Agent will request the principal London office of each of the Reference Banks to provide a quotation of its rate. If at least two quotations are provided, the rate for that Reset Date will be the arithmetic mean of the quotations. If fewer than two quotations are provided as requested, the rate for that Reset Date will be the arithmetic mean of the rates quoted by major banks in London, selected by the Calculation Agent, at approximately 11:00 a.m., London time, on that Reset Date for loans in euros to leading European banks for a period of the Designated Maturity commencing on that Reset Date and in a Representative Amount.*
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> *Section 7.1(f) of the ISDA Definitions*

If fewer than two quotations are provided to the Calculation Agent, the rate will be the arithmetic mean of the rates quoted by major banks in London, selected by the Calculation Agent, at approximately 11:00 a.m., London time, on that Reset Date for loans in Euros to leading European banks for a period of the Designated Maturity commencing on that Reset Date and in a Representative Amount.

## 2.2 Rate Source for Departing States new currency

### 2.2.1 Summary

One of the first tasks for any Departing State establishing its new currency will be to provide rate sources for the redenominated obligations that previously referred to EUR rates of interest.

### 2.2.2 Mechanism for introducing a new rate source

The redenomination legislation will establish the new currency as the lawful currency of the Departing State, replacing the Euro, and specifying the classes of obligations that will be redenominated from Euro into the new currency.

Where those obligations provide for payments of interest by reference to EUR rates, the Departing State must designate a rate source (e.g. a publication by the national central bank) that will apply to the redenominated obligations.  As the redenominated obligations are likely to include retail debt (e.g. mortgages of residents in the Departing State) and corporate finance debt (bonds and loans between corporates and banks) there may be more than one rate source provided (e.g. a general base rate and an interbank rate).

Once these new rate sources have been established the ISDA Definitions and FX Definitions will need to be supplemented to provide an industry standard definition that can be used in ISDA documentation.