Commentary on the 2001 Euro Protocol

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I. EURO ANNEXES

1. *Introduction*

In response to concerns voiced by its members, ISDA's Euro and Operations Committees met to consider an appropriate standard set of provisions that could be used to address issues at a master agreement level related to the final transition to the euro. Annexes 1 to 4 to the 2001 Euro Protocol (the "Protocol") reflect the outcome of those meetings.

ISDA published the ISDA EMU Protocol in 1998 and, in 2000, the ISDA EMU Protocol (Greece). Both of these Protocols were designed to allow parties to address certain issues arising out of the introduction of the euro. The 2001 Euro Protocol builds on the foundations established by those original Protocols and provides parties with the opportunity to finalize details relating to payments, rate fixings, redenomination of notional amounts, accounts for payments and payment netting.

Annexes 1 through 4 to the Protocol (together the "Euro Annexes") are intended to enable parties to an ISDA Master Agreement (in the forms discussed below) to amend that ISDA Master Agreement to confirm their intentions regarding the ultimate replacement of certain European national currencies by the euro.

The ISDA Master Agreements to which each of the Euro Annexes are applicable differ; specifically, Annexes 1 and 2 are applicable to the ISDA Master Agreement (Multicurrency – Cross Border), the ISDA Master Agreement (Local Currency – Single Jurisdiction), the ISDA Interest Rate and Currency Exchange Agreement and the ISDA Interest Rate Swap Agreement, while Annexes 3 and 4 are applicable to the ISDA Master Agreement (Multicurrency – Cross Border) and the ISDA Interest Rate and Currency Exchange Agreement. This is because Annexes 3 and 4 deal only with Master Agreements under which payments in a variety of currencies may be made. The term "Master Agreement" is therefore used in accordance with these limitations in the discussion of these Annexes. All section references in this Commentary are to the more widely used Multicurrency-Cross Border version of the ISDA Master Agreement, unless specifically indicated otherwise.

2. *Background*

The background to the Euro Annexes is that on January 1, 2002, the national currencies of the participating 12 states (Austria, Belgium, Finland, France, Germany, Greece, Netherlands, Ireland, Italy, Luxembourg, Portugal, and Spain) will cease to have any continuing relevance. Since January 1, 1999 (or January 1, 2001 in the case of the Greek Drachma), these national currencies have had limited relevance as denominations of the euro. From January 1, 2002, however, the national currencies will no longer even be denominations of the euro and, from that point onwards, obligations to pay sums originally denominated in a national currency unit will be capable of being discharged only in the euro unit.

3. *Deadline for Adherence to Euro Annexes*

The Euro Annexes are subject to an inherent deadline. In the case of most of the Euro Annexes, the deadline corresponds with the January 1, 2002 date for the disappearance of the national currencies. For Annex 1 (as discussed below), however, the deadline arises out of certain problematic dates in the last weeks of December, 2001. In order to ensure that changes effected by the Euro Annexes are in place prior to these deadlines, to give parties sufficient time to determine whether their counterparties have adhered to the Protocol, and to put in place the relevant operational procedures, a cut-off date prior to year-end exists in regard to the Protocol (see Section 2(a)(i) of the Protocol). Those who wish to take advantage of the Protocol process to amend their agreements on the terms of any of the Euro Annexes will therefore need to adhere to the Protocol on or before November 30, 2001.

II. ANNEX 1

Since 1999 when the euro was first introduced, the European Central Bank has increased the number of weekdays in each year on which the TARGET system will be closed. In 1999, only January 1st and December 25th were TARGET holidays. In 2000, TARGET was also closed on Good Friday, Easter Monday, Labour Day (1st May) and 26th December, and the ECB has announced that this will reflect the TARGET calendar for 2002 onwards as well. In 2001, the ECB will close TARGET additionally on 31st December.

One consequence of these additional TARGET closing days is that there are now more days that may be good banking or business days in the financial center for a national currency, but that are days on which TARGET is closed. This situation presents a problem for two primary areas addressed by Annex 1: rate fixing and settlement.

1. *Rate Fixings*

Confirmations for Transactions involving the payment of amounts related to floating rates of interest will typically specify, through the relevant set of ISDA Definitions, that the floating rate is to be determined by reference to rates appearing in a published source on a particular day. Typically, the day on which the rate is taken from that published source will be adjusted if that day would otherwise fall on a day that is not a good banking or business day in the financial center of the national currency. In the case of floating rates that have evolved from national currency rates into EURIBOR, parties can only be confident of obtaining a truly representative rate on any day if that day is one on which TARGET is open. This is because the euro-zone interbank deposit market for euros tends to be most liquid on those days.

Market practice, as reflected in the provisions of the ISDA EMU Protocol and the ISDA EMU Protocol (Greece) has been to maintain legacy rate fixing practices, so that where the national currency unit rate option originally selected by the parties called for the rate to be determined, for example, two Frankfurt banking days prior to the first day of the calculation period, parties continue to take the rate from the screen two Frankfurt banking days prior, even if that day is not a good TARGET day. Because of the liquidity effect noted above, the rate determined on that day may not reflect a truly representative rate.

The preferred solution to this problem, as indicated in the results of a survey conducted by ISDA among its members in July 2000, was, where rate fixing falls to be carried out on days that may be good business or banking days for the national currency unit concerned, to use the EURIBOR rate for the immediately preceding day that is a good TARGET day. This is reflected in Annex 1.

2. *Payments*

Because payments of national currency unit amounts are now effected by way of the euro payment system, cross border payments, whether of national currency unit amounts or euro amounts, may be impossible or impracticable on days on which TARGET is closed. This means that unless the relevant payment was being made between accounts held within one payment system (which was open), that payment could not be made.

Responses to ISDA's July 2000 survey indicated a clear preference to follow the remedy set out in Annex 1. Where a payment falls to be made on a day that may be a good business day for the national currency unit, but is a day on which TARGET is closed, the preference expressed was to postpone payment until the next day that is both a business day in the relevant place and a TARGET settlement day, and, for those Transactions where calculation periods or interest accrual periods run from payment date to payment date, thereby to extend the relevant calculation period to the extent of that postponement.

As noted above, the issues addressed by the amendments set out in Annex 1 arise whenever TARGET is closed but the financial center for a national currency unit is open. This situation will exist over the Christmas period in 2001. As a result, if parties adhere to the Protocol in respect of Annex 1 prior to the November 30 cut-off date, the Annex 1 amendments will come into effect on December 17, 2001, prior to the problematic period.

3. *Scope*

The provisions of Annex 1 apply to all Transactions documented under ISDA Master Agreements (being agreements in the form of the ISDA Master Agreement (Multicurrency - Cross Border), the ISDA Master Agreement (Local Currency - Single Jurisdiction), the ISDA Interest Rate and Currency Exchange Agreement or the ISDA Interest Rate Swap Agreement), which Transactions are entered into on or before November 30, 2001 and where the Confirmation for that Transaction incorporates, or is deemed to incorporate, a set of ISDA Definitions.

III. ANNEX 2

With the introduction of the euro, Transactions originally denominated in a national currency unit will effectively be redenominated into euros at the relevant official conversion rate. While this process will occur by operation of law, a significant number of ISDA members have indicated a desire also to address the issue by way of a contractual provision. This provision is reflected in Annex 2.

Annex 2 consists of an express recognition by the parties that Transactions that reference a national currency unit notional amount will, with effect from January 1, 2002, be treated as though they were subject to a euro notional amount.

Annex 2 does not require the parties to reconfirm Transactions that may be subject to its provisions.

Scope

The provisions of Annex 2 apply to all Transactions documented under ISDA Master Agreements (being agreements in the form of the ISDA Master Agreement (Multicurrency - Cross Border), the ISDA Master Agreement (Local Currency - Single Jurisdiction), the ISDA Interest Rate and Currency Exchange Agreement or the ISDA Interest Rate Swap Agreement), which Transactions are entered into on or before December 31, 2001 and where the Confirmation for that Transaction incorporates, or is deemed to incorporate, a set of ISDA Definitions.

IV. ANNEX 3

Annex 3 is designed to provide certainty in the operations area by allowing parties to assume that a euro account previously advised to them by a counterparty may be used for any euro payments required to be made to that counterparty after January 1, 2002. The concern among members was that they would be required to make euro payments but that they would not have been expressly informed that payments should cease being made to the national currency unit account to which previous payments had been directed.

Scope

The provisions of Annex 3 apply to all payments to be made pursuant to an agreement in the form of the 1992 ISDA Master Agreement (Multicurrency - Cross Border) or the ISDA Interest Rate and Currency Exchange Agreement.

V. ANNEX 4

As noted above, in preparation for the introduction of the euro on 1st January, 1999, the consensus among financial market participants was that Transactions entered into before that date which involved a currency of a state that adopted the euro should continue to be subject to those market conventions agreed on at the outset of the trade. This approach was reflected in Annex 3 of the ISDA EMU Protocol. Annex 3 made it clear that the provisions of ISDA standard form master agreements that provide for netting of payments falling due in the same currency should not apply where the payments, although technically due in the same currency (the euro) were actually expressed in different national currency units.

Annex 3 of the ISDA EMU Protocol was expressly limited so that it only applied for the duration of the transition period (ending on December 31, 2001). Annex 4 provides further clarity on this issue and allows party to recognize expressly in their contracts that with effect from January 1, 2002, the payment netting provisions of ISDA standard form master agreements will require netting of payments originally denominated in national currency units, whether against payments originally denominated in another national currency unit or the euro unit itself.

Scope

The provisions of Annex 4 apply to all payments to be made pursuant to an agreement in the form of the 1992 ISDA Master Agreement (Multicurrency - Cross Border) or the ISDA Interest Rate and Currency Exchange Agreement.