

# Global Documentation Steering Committee

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November 15, 2004

The Group of Thirty  
1990 M Street, Suite 450  
Washington, DC 20036  
Attention: John G. Walsh, Executive Director

## Re: Initiatives of the Global Documentation Steering Committee Relating to the Group of Thirty Recommendation 16

The Global Documentation Steering Committee (GDSC) was extremely pleased that you invited us to send a representative to the Group of Thirty (G30) meeting in Rome on Friday, October 22, 2004 to launch a G30 Legal Subcommittee. Sharmini Mahendran, who attended on our behalf, reported back that you requested a summary of some of the GDSC efforts to enhance documentation risk reduction.

The information below summarizes the role of the GDSC and the overlay between our efforts and the work of the G30 Monitoring Committee. We hope you find this useful and look forward to continued interaction between the G30 and the GDSC.

**GDSC Mission.** The mission of the Global Documentation Steering Committee (GDSC) has been to implement the documentation-related recommendations in the 1999 Report published by the Counterparty Risk Management Policy Group (CRMPG, a group of 12 major, internationally active commercial and investment banks formed with the objective of promoting enhanced strong practices in counterparty credit and related risk management after the market disruptions of 1997 and 1998) to create standardized documentation that can provide counterparties with uniform provisions in order to avoid documentation inconsistencies and, thereby, reduce risk and improve functioning of markets. More recently, the GDSC has also focused on market practices and procedures relevant to the documentation process. The GDSC's members include industry groups such as ISDA, TBMA, EMTA, LSTA and MFA, as well as market participants that include major dealers, corporations and end-users of financial products. The GDSC is sponsored by, but independent of, the Federal Reserve Bank of New York.

**Connection to G30 Recommendations.** The GDSC's recommendations and work to date support the Group of Thirty's Recommendation 16 relating to close-out valuation methodology and netting agreements. For example, the GDSC's work relating to providing a more flexible close-out valuation methodology in the 2002 ISDA Master Agreement (described in #1 below) directly relates to Recommendation 16's mandate that all master agreements should provide the determining party with the flexibility to value transactions by the method most likely to produce a commercially reasonable valuation at the time of termination. Similarly, the GDSC's work on cross-default (#2 below), default notices (#3 below), harmonization of time frames (#4 below) and bankruptcy event of default (#5 below) support the recommendations relating to close-out netting provisions and the speedy and accurate resolution of claims in Recommendation 16. The GDSC's recent focus on best practices for negotiating master agreements (#8 below) promotes the goal in Recommendation 16 of encouraging the execution of master netting agreements. Other related recommendations of the GDSC are also described below.

### **1) Close-out Amount Valuation**

The GDSC was very involved in an industry-wide discussion of the appropriate close-out valuation methodology for the 2002 ISDA Master Agreement. This discussion ultimately resulted in the “Close-out Amount” definition in the 2002 ISDA Master Agreement, which provides market participants with added flexibility to employ, in good faith, commercially reasonable procedures in circumstances where market quotations may not be available as a basis for determining settlement amounts.

### **2) Cross-default Provisions**

The GDSC has recommended that industry standard documentation include a uniform cross-default provision allowing for the termination of a trading relationship upon the occurrences of matured defaults under indebtedness or trading transactions in amounts in excess of a materiality threshold. The GDSC has also concluded that the historical reasons for maintaining both cross-default and cross-acceleration provisions (collectively, cross provisions) do not outweigh the virtues of having a single, consistently applicable cross provision.

### **3) Default Notices**

The GDSC has recommended that industry-standard documentation include the following standard forms of default notice:

- *Notice of Obligation that Anticipates Default.* This form is intended to put a counterparty on notice that there exists an obligation that if not satisfied would entitle the notice sender to declare the recipient to be in default. This notice would only be sent prior to the occurrence of an event that would entitle a party to declare the other to be in default, and need not be sent prior to any of the other forms of notice.
- *Declaration of Default.* This notice would be sent to a defaulting party following the occurrence of a default. If a grace period must run prior to the exercise of remedies, that grace period would be recognized in the notice. Depending on whether the nondefaulting party shall have exercised its default remedies prior to the sending of the notice, the notice will read differently: (i) in the event that default remedies shall not yet have been exercised, the notice will inform the defaulting party that the exercise of remedies is pending and (ii) if remedies shall have been exercised already, the notice will inform the recipient of the results of such exercise.
- *Post-Default Declaration Notice of Damage Calculation and Demand for Payment.* This form is to be used as a follow-up to the Declaration of Default in the event that the default notice is sent prior to the remedies having been exercised.

### **4) Harmonization of Timeframes**

The GDSC has addressed differences in close-out timeframes under various master agreements and advocated that a party to a financial contract should be able to declare an event of default for any non-payment no later than one local business day after notice of non-payment, including for non-payment of interim payments, mark-to-market payments, payments in lieu of interest under repurchase agreements, tax gross-up payments, and payments/returns at maturity. Consistent with this, the grace period for non-payment events of default was reduced to one business day in the 2002 ISDA Master Agreement, compared to the three business day grace period in the 1992 ISDA Master Agreement.

### **5) Bankruptcy Event of Default**

The GDSC has reviewed the bankruptcy events of default in several widely used industry standard master agreements. Although the provisions employed different language and drafting styles, the fundamental themes of the various bankruptcy triggers were, for the most part, consistent across the agreements. However, two notable exceptions were the “inability to pay debts generally as they become due” and the “catch-all” bankruptcy triggers, and the GDSC has recommended that these two triggers be added to master agreements.

## **6) Force Majeure Provision**

The GDSC has published a recommended definition of force majeure which encompasses two broad categories of events: (i) those that preclude performance as a result of force majeure or an act of state and (ii) those that would render performance illegal. The recommended definition explicitly states that, other than in the context of illegality, the event or circumstance must be beyond the control of the affected party and the affected party must have taken precautions commonly adopted by financial market participants to anticipate, and must be unable with reasonable diligence to overcome, such event or circumstance.

## **7) Adequate Assurances Provision**

The GDSC has determined that, in certain circumstances, it may be appropriate to include an adequate assurances clause in both (i) master agreements for financial market transactions and (ii) confirmations of financial market transactions that are not subject to master agreements, subject to the following:

- A demand for adequate assurances must be based on “reasonable grounds for insecurity.” The party making a demand for adequate assurances must have a demonstrably solid foundation for the demand, based on what a party would deem reasonable under similar circumstances.
- The enforceability in bankruptcy or otherwise of an adequate assurances provision will depend, in part, on:
  - how a party exercises its right to request adequate assurances;
  - what form of assurances are requested and if collateral or other value is requested to be transferred; and
  - the method by which such collateral or value is transferred and documented.

## **8) Practitioner’s Best Practice Guide**

The GDSC recently produced a guide to “best practices” in negotiating master agreements. This guide will be the subject of a seminar to be held at the Federal Reserve Bank of New York on November 19, 2004. The four underlying principles of the guide are as follows:

- Parties to trading agreement negotiations should identify the important issues between them and each involve appropriate decision-making personnel early in the process.
- The parties should set a time frame for negotiations and stick to it.
- Both internal and external (bilateral) lines of communication must be established and maintained.
- Personnel involved in the negotiations must be committed to advancing the process and overcoming negotiation roadblocks.

## **9) Confidentiality Agreement**

The GDSC is in the process of finalizing standard Confidentiality Terms, which allow parties to apply such terms to specific information being provided by one party to the other party through the use of a streamlined, standard-form confirmation.

Once again, thank you for engaging the GDSC in the G30's efforts. If you have any questions, please don't hesitate to contact us.

Very truly yours,



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Vice Chairman,  
Lehman Brothers



Jane D. Carlin, Committee Co-Chairperson  
Managing Director,  
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cc: Philipp Paech, UNIDROIT