

# **PRACTICE NOTES TO THE MASTER CONFIRMATION AGREEMENT FOR NON-DELIVERABLE CURRENCY OPTION TRANSACTIONS**

## INTRODUCTION

The Master Confirmation Agreement for Non-Deliverable Currency Option Transactions (“NDO Master Confirmation”) was published on July 1, 2008 by the Foreign Exchange Committee (FXC), with the support of the Financial Markets Lawyers Group (FMLG), and the Master Confirmation’s co-sponsors, EMTA, Inc. (EMTA) and the Foreign Exchange Joint Standing Committee (FX JSC).

The FXC published the NDO Master Confirmation to facilitate the electronic confirmation of non-deliverable currency option transactions (“NDO Transactions”) under the 1998 FX and Currency Option Definitions published by the International Swaps and Derivatives Associations, Inc. (ISDA), EMTA, and the FXC (the “1998 Definitions”). EMTA has also published currency-specific terms (“EMTA NDO Templates”) to be used in conjunction with the NDO Master Confirmation.

The NDO Master Confirmation is a bilateral agreement for use by parties that enter into NDO Transactions. It takes the form of a confirmation so that, as a general matter, it can be executed by operations personnel that have the authority to execute confirmations for their firm.<sup>1</sup> The NDO Master Confirmation also reflects the increasing demand for a flexible form of master confirmation that recognizes a wide variety of methods to create and deliver Transaction Confirmations.

The NDO Master Confirmation incorporates by reference the terms of the currency-specific EMTA NDO Templates, which are published and available at [www.emta.org](http://www.emta.org). It is anticipated that EMTA will, from time to time, issue new or amend existing EMTA NDO Templates. The new and updated EMTA NDO Template for the relevant currency pair that is in effect on the trade date of an NDO Transaction will apply automatically to the transaction. However, any EMTA NDO Template that is amended or newly issued after the trade date of a NDO transaction will not apply to, or amend, previously executed NDO Transactions, unless the parties agree otherwise.

The Master Confirmation sets out Economic Terms of NDO Transactions to be included in a Transaction Confirmation, which may be executed by fax, telex, e-mail, or electronic messages exchanged between the parties or matched on an electronic system. Because a major objective of the Master Confirmation is to facilitate use of a wide variety of methods of confirming NDO Transactions, the co-sponsors anticipate that electronic systems may be interested in implementing it on a multilateral basis for the benefit of their members. The co-sponsors will work with any interested electronic

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<sup>1</sup> Each firm should make its own determination as to whether its operations personnel have authority to execute the NDO Master Confirmation.

system in developing an appropriate multilateral form of the Master Confirmation for purposes of its implementation in the electronic system.<sup>2</sup>

It should also be noted that the NDO Master Confirmation accommodates NDO Transactions with a U.S. Dollar Settlement Currency only. However, it may accommodate cross-currency NDO Transactions with a non-U.S. Dollar Settlement Currency with some amendment. At present, there is no standard market practice for documenting cross-currency NDO Transactions with a non-U.S. Dollar Settlement Currency. Parties seeking to specify terms to standardize, on a bilateral basis, their cross-currency NDO Transactions may wish to include the language set forth in the Addendum of these practice notes.

The practice notes below provide further explanation of the provisions of the Master Confirmation. All capitalized words in these practice notes have the meanings given to them in the NDO Master Confirmation or the 1998 Definitions, unless otherwise specified herein.

#### PARAGRAPH 1: APPLICATION

Paragraph 1 defines the scope of the NDO Master Confirmation. The NDO Master Confirmation only applies to European style currency option transactions and is not suitable for use with other option styles.

The parties entering into the NDO Master Confirmation intend that it govern all NDO Transactions between them that are entered into on or after its effective date (unless the parties so specify in the Addendum or in a Transaction Confirmation that the Master Confirmation does not apply). For example, if the parties enter into a customized NDO Transaction with a long-form confirmation that should stand on its own terms, such confirmation should specify that the Master Confirmation does not apply to it. Similarly, parties can exclude from the scope of the Master Confirmation any class of NDO Transactions (such as NDO Transactions involving a particular Currency Pair) by specifying this in Part 6 of the Addendum.

#### PARAGRAPH 2: FX DEFINITIONS

The Master Confirmation incorporates the terms of the 1998 Definitions, as those terms may have been modified or amended in the Master Agreement between the parties. Any amendments to the 1998 Definitions, or successor definitions that replace the 1998 Definitions, are incorporated into the NDO Master Confirmation only on a prospective

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<sup>2</sup> Each firm should review with its counsel whether it would be comfortable with relying on a particular electronic system to confirm its NDO Transactions, in light of applicable laws, rules, and procedures specific to the electronic system. The co-sponsors do not make any representations about using any particular electronic system to confirm their NDO Transactions, even if that system does implement the Master Confirmation.

basis. Any amendments or successor definitions to the 1998 Definitions will only apply to new NDO Transactions with trade dates that fall on or after the effective date of the amendments or successor definitions in question. Any previously outstanding NDO Transactions will not be affected. The parties, however, may agree to change this general rule (e.g., in a separate bilateral agreement or a subsequent agreement that applies on a multilateral basis).

#### PARAGRAPH 3: TRANSACTION CONFIRMATION

The parties must create a Transaction Confirmation for each NDO Transaction entered into together. Paragraph 3 makes clear that the Transaction Confirmation may be created by fax, telex, e-mail, or through the facilities of electronic messaging, trading or settlement systems (including, and without limitation, by means of the system matching electronic messages sent by each party). As noted in the Introduction above, the co-sponsors do not make any representations regarding whether firms will or should rely on any particular electronic system to confirm their NDO Transactions, even if it does implement the Master Confirmation. Each firm should review with its counsel whether it would be comfortable with relying on a particular electronic system to confirm its NDO Transactions, in light of applicable law, rules, and procedures specific to the electronic system.

#### PARAGRAPH 4: RELEVANT EMTA TEMPLATE

For each NDO Transaction governed by the NDO Master Confirmation, Paragraph 4 incorporates the terms of the relevant EMTA NDO Template (“Relevant EMTA Template”) for confirming a NDO Transaction in the relevant Currency Pair that is effect at the time, as published by EMTA or a recognized successor, unless the parties otherwise agree in the Addendum or a Transaction Confirmation. For example: Assume the relevant currencies for an NDO Transaction are the Argentina Peso (ARS) and the U.S. Dollar. If the date of the Relevant EMTA Template for the Argentina Peso (ARS) – U.S. Dollar Currency Pair is dated May 17, 2006, and the date of the trade is December 15, 2008, the terms of the Relevant EMTA Template would be incorporated by reference (unless the parties otherwise agree in the Addendum or a Transaction Confirmation). The incorporated terms include: the Settlement Rate Option, Disruption Events, Disruption Fallbacks, definitions and provisions related to “Unscheduled Holiday,” Deferral Period for Unscheduled Holiday, “Valuation Postponement” for Price Source Disruption, Cumulative Events, Maximum Days of Postponement, and Relevant Cities for Business Days for Valuation Date and Settlement Date. Accordingly, if the parties agree to Paragraph 4, they do not need to additionally specify any of these terms.

The parties are free, however, to agree to exclude any terms of Relevant EMTA Templates to all or any class of NDO Transactions. The proviso (“. . . except to the extent otherwise provided in the Addendum or a Transaction Confirmation”) allows

parties to alter this general incorporation by reference. In such case, Part 6 of the Addendum or the Transaction Confirmation must specify which terms do not apply.

NDO Templates published by EMTA are available on its website at [www.emta.org](http://www.emta.org). EMTA may publish new NDO Templates in advance of their specified effective date in order to give the market notice of the new terms and time to make necessary adjustments. Paragraph 4 provides that the terms of a new EMTA NDO Template will not apply to a NDO Transaction in the relevant Currency Pair until the terms become effective. Only when the terms become effective will the EMTA NDO Template fall under the definition of a Relevant EMTA Template in the Master Confirmation. In addition, the terms of a Relevant EMTA Template will apply to NDO Transactions entered into on or after their effective date, but will not apply to or amend the terms of previously executed NDO Transactions, unless otherwise agreed by the parties. For example, the parties may agree to a protocol that retroactively applies the terms of the new EMTA NDO Template to outstanding NDO Transactions, which would supersede this limitation in Paragraph 4.

#### PARAGRAPH 5: ECONOMIC TERMS

Paragraph 5 sets out the Economic Terms for each NDO Transaction that must be specified in the Transaction Confirmation. These Economic Terms are: Trade Date, Buyer, Seller, Put Currency and Put Currency Amount, Call Currency and Call Currency Amount, Option Style (this is preset at European), Option Type, Reference Currency, Settlement Currency, Strike Price, Settlement Date, Settlement, Valuation Date, Premium, and Premium Payment Date. These terms must be provided by the parties for each trade conducted. The Relevant EMTA Template will contain certain provisions relating to the impact of an Unscheduled Holiday or Price Source Disruption, as well. These provisions will apply automatically to a NDO Transaction in the relevant Currency Pair.

Electronic messaging, trading and settlement systems have different message formats, and it is possible that not all of them will permit for specification in a Transaction Confirmation of all of the Economic Terms listed in Paragraph 5. The co-sponsors believe, however, that parties should be free to agree to use the facilities of various electronic systems to confirm their NDO Transactions under the Master Confirmation. Accordingly, Paragraph 5 allows for the specification in the Transaction Confirmation of terms different from those listed in Paragraph 5. This alternative is intended to facilitate use of different formats of electronic messaging, and not to provide a broader exception to the need to specify in the Transaction Confirmation the listed Economic Terms, which are material to a NDO Transaction.

Paragraph 5 further specifies that, for a NDO Transaction to be governed by the Master Confirmation, the Transaction Confirmation must provide, or the parties must otherwise agree in the Transaction Confirmation, that Settlement is Non-Deliverable. This requirement is intended to provide certainty on the universe of NDO Transactions

between the parties that will be covered by the NDO Master Confirmation. If an electronic message format does not include a field for specifying that Settlement is Non-Deliverable, it must otherwise be clear from the terms of the Transaction Confirmation that the NDO Transaction is Non-Deliverable. For example, some electronic systems may require use of a particular message type for NDO Transactions.

#### PARAGRAPH 6: PRIORITY

The rules of priority specify that the terms of the Confirmation of a NDO Transaction prevail over those of the FX Definitions (including any amendments or successors to the 1998 Definitions, if they apply to a NDO Transaction in accordance with Paragraph 2). In addition, the terms of the Confirmation prevail over the Master Agreement. As the Confirmation incorporates the 1998 Definitions, this paragraph has the effect of providing that the 1998 Definitions also prevail over the Master Agreement.

The terms of the Addendum or Transaction Confirmation prevail over those of a Relevant EMTA Template, subject to an exception. When the parties have specified in the Addendum general terms for a NDO Transaction in a Currency Pair that currently is not the subject of an EMTA NDO Template (for example, a cross-currency NDO) and, after the effective date of the Addendum, EMTA publishes NDO Template terms for that Currency Pair, those terms will apply to NDO Transactions entered into on or after their effective date, and will supersede the customized terms set out in the Addendum. In order to modify this approach generally, or with respect to any particular NDO Transaction, the parties must agree to do so on a bilateral basis.

The NDO Master Confirmation also makes provisions for the potential creation of a multilateral form of a master confirmation agreement for NDO Transactions (a “Multilateral Master Confirmation”), which may be adopted at some point in the future by one or more electronic messaging, trading or settlement systems. Paragraph 6(c) provides the rules of priority in the event of any inconsistency between a Multilateral Master Confirmation and any bilateral Master Confirmation that may govern a previously contracted NDO Transaction, unless otherwise agreed by the parties.

#### PARAGRAPH 7: QUOTING DEALER DISCLAIMER

The quoting dealer disclaimer is commonly used and included in the EMTA NDO Templates to disclose the fact that dealers may be asked to participate in industry-wide surveys that will establish a settlement rate for a Currency Pair that is the subject of a NDO Transaction between the parties.

#### PARAGRAPH 8: REPRESENTATIONS

The representations in paragraph 8 are standard legal enforceability and nonreliance representations also found in industry master agreements.

#### PARAGRAPH 9: GOVERNING LAW/JURISDICTION

Paragraph 9 makes clear that the election of governing law and the provisions on submission of jurisdiction in the Master Agreement – either executed between the parties or in the form elected in the Addendum – apply to the Master Confirmation.

#### ADDENDUM

The Addendum is part of the bilateral version of the Master Confirmation and provides a means for specifying counterparty-specific terms.

Part 1 (Master Agreement) requires the parties to specify the Master Agreement they have entered into or, if they have not entered into a Master Agreement, to specify the form of Master Agreement that will apply for purposes of the Master Confirmation (together with an election of governing law and the Termination Currency/Base Currency).

Part 2 (Calculation Agent) requires the parties to elect whether one or both parties will act as Calculation Agent.

Part 3 (Account Details), Part 4 (Contact Information), Part 5 (Representations), and Part 6 (Other Terms) allow for the specification of other relevant provisions.

In particular, Part 6 enables the parties to: (i) change the terms of Relevant EMTA Templates that otherwise would apply to their NDO Transactions under the operation of Paragraph 4; (ii) vary any other terms of the Master Confirmation; (iii) provide customized terms that will apply to NDO Transactions in Currency Pairs for which a Relevant EMTA Template does not exist; and (iv) carve out any class of NDO Transactions from the scope of the Master Confirmation (see paragraph 1 above).

Currently, no standard market practice exists for documenting cross-currency NDO Transactions. However, parties seeking to specify terms to standardize, on a bilateral basis, their cross-currency NDO Transactions may wish to include the following provision in Part 6:

This Master Confirmation shall apply to Cross-Currency NDO Transactions, which means NDO Transactions for which the Transaction Confirmation specifies: (i) that Settlement is Non-Deliverable; and (ii) the Settlement Currency is not covered by a Relevant EMTA Template on the Trade Date of the Cross-

Currency NDO Transaction. In such cases, a Relevant EMTA Template (that is effective on the Trade Date of the NDO Transaction) shall be the confirmation template for the Reference Currency specified in the Transaction Confirmation, and all of the terms of such Relevant EMTA Template shall apply to such NDO Transaction, except as follows: (i) the Settlement Rate Option specified in the Relevant EMTA Template shall be deemed to be the Reference Currency Spot Rate for the Cross-Currency NDO Transaction; and (ii) the Settlement Rate Option for the Cross-Currency NDO Transaction shall mean the Cross-Currency Spot Rate, which shall be determined by reference to the Reference Currency Spot Rate and the Settlement Currency Spot Rate on the Valuation Date. The Transaction Confirmation shall specify the following Economic Terms for a Cross-Currency NDO Transaction, in addition to those listed in paragraph 5 of the Master Confirmation:

Cross-Currency Spot Rate

Settlement Currency Spot Rate