FORCE MAJEURE: USER'S GUIDE TO THE NEW PROVISIONS

This user's guide is released by the Foreign Exchange Committee to accompany revisions published by the Committee on this date (the "new provisions") to the Force Majeure, Act of State, Illegality and Impossibility Section ("force majeure provision") of the International Foreign Exchange Master Agreement (IFEMA), International Foreign Exchange and Options Master Agreement (FEOMA) and International Currency Options Market Master Agreement (ICOM and, collectively with IFEMA and FEOMA, the "agreements"), previously issued by the Committee in association with the British Bankers' Association, the Canadian Foreign Exchange Committee, and the Tokyo Foreign Exchange Market Practices Committee. This user's guide will provide background and other information to assist foreign exchange market participants in implementing the new provisions. The new provisions and this user's guide are not intended to interpret or define the scope of the agreements as now in effect.

BACKGROUND

In May 1998, in the wake of crises in various international financial and currency markets, the Committee's Financial Markets Lawyers Group formed a subcommittee to consider these events. In particular, the subcommittee was charged with considering whether, in the event of major market dislocations, the force majeure provisions of the agreements and other existing industry standard documentation would lead to a market-responsive result that was appropriate from a risk management perspective. The subcommittee received extensive comment from, and held meetings with, representatives of a large group of commercial and investment banks. In addition, nonvoting representatives of the International Swaps and Derivatives Association (ISDA), the Emerging Markets Traders Association (EMTA) and the Federal Reserve Bank of New York participated in this process.

PRELIMINARY CONCLUSIONS

The first conclusion of the subcommittee was that, in the event of the occurrence of an impossibility, illegality, or other force majeure event, the results under the agreements, as well as under other standard industry documentation such as the ISDA Master Agreement and relevant ISDA definitions, were not always consistent and did not appear to reflect current market practices or market needs. There also appeared to be some disagreement over how to interpret certain key terms of these documents. The subcommittee was concerned that these inconsistencies could cause market participants to take contradictory positions in times of market difficulty, leading to a reduced level of legal certainty and increased confusion in the market. Although the subcommittee members were aware that, in the wake of last year's disruptions, quick, decisive, and generally consistent action by market participants had prevented potentially destabilizing market reactions, the subcommittee as a whole was concerned that the result could be different in the future.

The subcommittee determined that the best way to achieve the goals the Committee had set for it would be to draft revised provisions that would address current market practice and needs. After consultation with the Committee, the subcommittee prepared the new provisions. The Committee believes the new provisions will provide guidance to the foreign exchange market on current best practices and respond to a perceived need to revise the force majeure provisions of the Committee's agreements.

USE OF THE NEW PROVISIONS

The subcommittee recognizes that each market participant retains the freedom to include or exclude particular provisions from some or all of its agreements and to negotiate whatever terms it deems appropriate with each of its counterparts. Accordingly, the new provisions will apply only to the extent that market participants choose to include them in new agreements or to amend existing agreements to replace current force majeure provisions with the new provisions. Nonetheless, because the Committee believes that the new provisions both reflect and promote best practice in the market, it expects that the new provisions will be used by many market participants.

The new provisions are designed to be amendments to the agreements and, as such, are generally intended to apply to deliverable foreign exchange transactions and options ("transactions"). Parties can, of course, elect to apply the new provisions to nondeliverable transactions. In addition, if the parties to an agreement are entering into nondeliverable transactions under that agreement, or using a comparable provision in an ISDA schedule, then any nondeliverable transaction governed by that agreement or by the ISDA Master Agreement would be covered by the new provisions. If the parties would prefer that specific disruption events—such as those cited in the 1998 ISDA, EMTA, and Committee Foreign Exchange and Currency Option Definitions (the "1998 foreign exchange definitions")—apply to their nondeliverable transactions, they should so provide in the applicable documentation.

The subcommittee also notes that there will undoubtedly be transactions under which, to meet the specific needs of the parties, the parties choose to allocate risk and elect specific disruption fallbacks that provide for outcomes different from those set forth in the new provisions. Even if parties to one or more of the agreements have adopted the new provisions, they can still elect to apply specific disruption events and disruption fallbacks to one or more transactions. The subcommittee refers market participants to the 1998 foreign exchange definitions, which contain many helpful definitions and other provisions in this regard.

To enable parties to give effect to the new provisions under outstanding documentation, the Committee has also released a "Form of Amendment to Incorporate the New Force Majeure Provisions into the IFEMA/FEOMA/ICOM Agreements." This form may be executed as an amendment or addendum to the appropriate agreement. It may also be adapted for use with ISDA or other master agreements, such as versions of the IFEMA and ICOM agreements published prior to 1997. The form makes clear that the new provisions govern all transactions, unless (as discussed in the preceding paragraph) the parties agree upon specific disruption events or disruption fallbacks for one or more transactions.

In March 1998, in connection with the publication of the 1998 foreign exchange definitions, the Committee published the 1998 Foreign Exchange and Currency Option Definitions Addenda for the IFEMA, ICOM, and FEOMA agreements. If the parties to an agreement have executed such an addendum, it is effective as a "bridge agreement" for the 1998 foreign exchange definitions. If these parties also adopt the new provisions, they agree to reverse a presumption in the bridge agreement that, unless otherwise specified in the confirmation, certain disruption events and disruption fallbacks automatically apply to all transactions executed by the parties under the relevant IFEMA, FEOMA, or ICOM agreement. (See the Guide to the 1998 Foreign Exchange Definitions Addenda for further information.) The new provisions are intended to supersede this provision of the bridge agreement by requiring the parties to expressly agree (in a manner contemplated by the relevant agreement) if they wish to apply specific disruption events or disruption fallbacks to one or more of their transactions in lieu of the new provisions.

EXPLANATION OF THE NEW PROVISIONS

The new provisions include a proposed new Section 6 for the IFEMA agreement and a proposed new Section 9 for the FEOMA and ICOM agreements, which would replace these sections of the agreements as published in 1997 (the "1997 provisions"). The subcommittee understands that an ISDA committee is reviewing the same issues at this time.

The principal changes from the 1997 provisions are as follows:

Definition of Force Majeure Event

To provide a more precise statement of the types of events that trigger the rights under the revised master agreements, the new provisions define the term "force majeure event." In addition to being more exact than the 1997 provisions, the new provisions entail the following substantive changes:

1. *Events covered*. The new provisions, like the 1997 provisions, cover any force majeure, act of state, illegality, or impossibility event that has the specified effect based on the particular facts and circumstances of that event. However, the new provisions make clear that, for an event to be a force majeure event, it must be beyond the reasonable control of the affected party to overcome.

2. *Events that will affect transactions in the future.* Under the 1997 provisions, a triggering event is deemed to occur in advance of the day on which a transaction is to settle if a party has a good faith belief that a force majeure or other relevant event will occur. The subcommittee was of the view that one party's good faith belief about a future event was not a high enough standard to permit early termination of transactions. However, the subcommittee was also of the view that, once a force majeure event affecting a currency had occurred, all transactions in that currency should be subject to early liquidation, even if the date on which the transactions were to settle was months or years in the future. This concept is now incorporated into the definition of the term "force majeure event."

3. *Termination of less than all transactions.* Of course, even if a party has the right to liquidate all affected transactions, a party may elect not to do so. This is particularly true when the force majeure event is one generally referred to as an act of God (such as a fire, earthquake, flood, or other natural event), the effect of which reasonably can be expected to pass within a period of time. However, there may be other force majeure events in respect of which a party chooses not to liquidate all affected transactions immediately after the waiting period. In order to grant the parties reasonable flexibility should they determine not to liquidate all transactions, the new provisions clarify that any party that elects to liquidate only some transactions can liquidate additional transactions on any later day or days if the relevant force majeure event is still in effect.

Waiting Period

In the 1997 provisions, before a party can exercise its right to terminate and liquidate transactions affected by a relevant event, it may be required during a twenty-day waiting period to attempt to transfer its obligations to another office through which it can perform (that is, transfer or receive the affected currency). The ISDA Master Agreement has a similar provision for illegality, but the waiting period extends to thirty days. In either case, the Committee recognizes that the concept of an extended waiting period is inconsistent with the operation of today's global foreign exchange marketplace. As a result, the new provisions remove this concept from the agreements.

In its place, the new provisions establish a standard "waiting period" of three business days before affected transactions can be terminated as a result of a force majeure event. During the waiting period, the parties would be unable to take any action to terminate or liquidate affected transactions solely by reason of the occurrence of a force majeure event. The Committee believes that, in many cases, waiting three business days will allow the precipitating event to pass, thereby avoiding what might be an unnecessary and disruptive liquidation of a market. In formulating the new provisions, many participants pointed to the financial crisis in Indonesia as a case in which the immediate termination and liquidation of transactions would have proved to be premature and unnecessary. However, if the force majeure event does not pass by the end of the waiting period, the waiting period will allow the marketplace to prepare for an orderly termination and liquidation of affected transactions.

Definition of Business Day

The subcommittee wished to clarify whether a force majeure event could cause a day not to be a business day (thereby extending the waiting period). The new provisions specify that a business day includes any day that, but for the force majeure event, would have been a business day. Accordingly, the occurrence of a force majeure event triggers, but does not affect the length of, the waiting period of three business days. (For example, December 31 would ordinarily be a business day since banks are generally open on that date unless it falls on a weekend; however, for 1999, it would not be a business day in any jurisdiction that announced significantly in advance of that date that it would be a banking holiday.)

Early Termination

If a force majeure event continues after the expiration of the waiting period, then the new provisions, in a manner similar to the 1997 provisions, grant each party the right (but not the obligation) to elect to liquidate any or all outstanding transactions involving the affected currency and to settle mark-to-market differences in U.S. dollars (or another unaffected currency), regardless of when the settlement date is scheduled to occur. As explained above, termination would apply to transactions involving the affected currency even when the settlement date for such transactions is several months or even years in the future.

The new provisions include one substantive change in this regard. Under the 1997 provisions, if both parties were affected by the relevant event, then the party that gave notice of the event made the necessary calculations. On consideration, the subcommittee did not view who gave notice as relevant to which party should calculate. In addition, this provision could result in a party's rushing to give notice at the first sign of a possible force majeure event in order to control the calculation, rather than waiting until the situation became clearer and, perhaps, resolved itself. The new provisions, by contrast, provide that if both parties are affected by the event, then both parties do the calculations in good faith, and the relevant amounts are the average of the calculations of the two parties. However, to avoid the situation in which one party elects to liquidate but the other refuses to provide the necessary calculations (even though this would clearly be a breach of the good faith requirement), the new provisions expressly state that if a party fails to so determine an amount, the amount determined by the other party shall govern.

If there is only one affected party, the new provisions and the 1997 provisions both specify that the nonaffected party performs the calculations. Although the new provisions permit liquidation of less than all affected transactions, the fact that only the nonaffected party performs the calculations when there is only one affected party should not present any concerns about "cherry picking"—that is, the possibility that the nonaffected party would liquidate those affected transactions favorable to it but not those which are unfavorable to it—because either party can elect which affected transactions are to be liquidated. Accordingly, if the nonaffected party elects to liquidate only some affected transactions, the affected party (even though it cannot perform the calculations) can determine that additional affected transactions are to be liquidated. It should be noted that cherry picking is generally a significant issue in the event of a party's insolvency, because the insolvent party could attempt to force performance of transactions favorable to it while rejecting or defaulting under transactions unfavorable to it, with damages to be paid at a fraction of full value. By contrast, when both parties are solvent, all obligations will eventually be satisfied (although in the interim, significant mark-to-market issues could arise).

The new provisions also make clear that it is the occurrence of a force majeure event, not notice of that event, that triggers the waiting period and any subsequent early termination of affected transactions.

It should be understood that at any time, including the waiting period, any two parties can agree to take an alternate action. It should also be understood that a party can still, of course, terminate and liquidate any transactions to the extent that its counterparty's failure to perform was not caused solely by a force majeure event (such as a bankruptcy or insolvency of a counterparty or its credit support provider, or a failure to provide adequate assurance or otherwise perform, even if caused, in part, by the force majeure event).

Treatment of an Event That Is Both a Force Majeure Event and an Event of Default

The subcommittee wished to avoid any confusion about the effect of an event that is both a force majeure event and an event of default. The new provisions make clear that such an event is treated as a force majeure event, not as an event of default. Of course, if an event occurs that is a force majeure event, and at the same time another event (other than the mere failure to make payment as a result of that force majeure event) occurs that constitutes an event of default under an agreement (for example, if a party becomes bankrupt or insolvent, even if that bankruptcy or insolvency is caused by the force majeure event), that other event would be an event of default under that agreement.

The Committee is presenting the new provisions to the foreign exchange market with the expectation that they will reflect and help strengthen best practice in this market and facilitate the maintenance of an orderly market during times of crisis.

FORM OF AMENDMENT TO INCORPORATE THE NEW FORCE MAJEURE PROVISIONS IN THE IFEMA/FEOMA/ICOM AGREEMENTS

WHEREAS, ____________ and ____________ (the "Parties") have entered into one or more of the International Foreign Exchange Master Agreement ("IFEMA"), International Foreign Exchange and Options Master Agreement ("FEOMA") and International Currency Options Market Master Agreement ("ICOM" and, collectively with IFEMA and FEOMA, the "Agreements"), issued by The Foreign Exchange Committee of the Federal Reserve Bank of New York (the Committee) in association with The British Bankers' Association, The Canadian Foreign Exchange Committee and The Tokyo Foreign Exchange Market Practices Committee; and

WHEREAS, the FX Committee has issued amendments to the Agreements which revise Section 6 of IFEMA and Section 9 of FEOMA and ICOM, and the Parties wish to amend the Agreements between them to reflect these revisions and certain other matters as set forth below;

NOW, THEREFORE, the Parties agree as follow:

1. *Each Agreement between the Parties now in effect is hereby amended by (a) deleting Section 6 (if it is an IFEMA) and Section 9 (if it is a FEOMA or ICOM), (b) inserting in its place the replacement Section attached hereto, and (c) making the other changes in the Agreement that are reflected on the attachment.*
2. *Notwithstanding any provision of the 1998 ISDA, EMTA and FX Committee FX and Currency Option Definitions (the "1998 Definitions"), any "Bridge Agreement" incorporating the 1998 Definitions, or the fact that the 1998 Definitions apply to any Agreement or Transaction, Article 5 of the 1998 Definitions does not apply to any Agreement or Transaction unless (and then only to the extent that) the Parties expressly agree that Article 5 is to apply and, in such event, Article 5 shall apply only to the specific Transactions as to which the Parties have so agreed. [Add if the Parties have a Bridge Agreement in effect: To the extent this Amendment is inconsistent with any such Bridge Agreement, this Amendment supersedes and is expressly intended to amend such Bridge Agreement.]*
3. *"Transaction" means an FX Transaction, Option or any other transaction as defined in any Agreement. Except as amended hereby, each Agreement remains in full force and effect.*

   [NOTE: If the Parties wish to use this form to incorporate comparable provisions into an ISDA or other Master Agreement, the Parties should define Agreements to include any other relevant Agreement, and refer to the appropriate amendments in the second WHEREAS clause and in paragraph 2.]

______________________________	______________________________
[Name of party]	[Name of Party]
By:______________________________	By ______________________________
Name:	Name:
Title:	Title: