UPDATE 1

1 January 2002

Contents

[U1.01] Introduction

In 2001, the AFMA Documentation Committee reviewed AFMA's "Guide to OTC Documents" ("**Guide**") with a view to harmonizing its documentation recommendations as much as possible with international documentation practices.

The major difference between Australian and international documentation practice is the use of the AFMA Australian Addenda in Australia.

Also, in the past 4 years or so, ISDA has published a number of Definitions booklets which has resulted in some inconsistencies between the Australian Addenda and international documentation practices.

The publication of these Definitions booklets has resulted in a lot of the material in the Australian Addenda becoming redundant.

[U1.02] Review process

The review was aimed at:

- identifying those elements of the Australian Addenda which have become redundant in view of the recent ISDA Definitions publications or changes in market practice; and

- identifying whether there is anything in the recent ISDA Definitions publications which might be unenforceable under Australian law.

The review was done in two parts:

- AFMA instructed Mallesons Stephen Jaques to advise on general regulatory and legal issues arising from using the new ISDA Definitions and ceasing to use the Australian Addenda; and

- AFMA requested feedback from market participants on commercial ramifications from ceasing to use the Australian Addenda.

Mallesons Stephen Jaques' opinion can be viewed from a link at the contents page for volume 1.

[U1.03] Outcome

The outcome of the review is that AFMA recommends that the Australian Addenda no longer be used. Instead, AFMA recommends using a combination of the following:

- incorporating ISDA Definitions into the Confirmations for transactions covered by Australian Addenda such as:

  - 1997 ISDA Bullion Definitions and 1997 ISDA Short Form Bullion Definitions;

  - 1997 ISDA Government Bond Option Definitions;

  - 1998 ISDA FX & Currency Option Definitions;

  - 2000 ISDA Definitions; and

  - 2000 Supplement to the 1993 ISDA Commodity Derivative Definitions, and using ISDA rather than Australian terminology in Confirmations;

- no longer using Australian Addenda No's 1 to 12 (Australian Addendum No. 13 - Electricity Transactions should still be used for Australian electricity derivative transactions);

- using the PSA/ISMA Global Master Repurchase Agreement to document reciprocal purchase transactions (repos) (and possibly linking it to an ISDA Master Agreement - see [18.22]; and

- adding new clauses to Part 5 of the Schedule of Master Agreements or to Confirmations to address the few substantive "gaps" resulting from this process.

[U1.04] ISDA Definitions booklets

AFMA recommends that participants use ISDA Definitions booklets for all types of transactions that can be documented under them. However, this must be done with care. In addition to addressing legal (contractual) issues, the ISDA Definitions booklets incorporate many commercial terms by reference. It is important therefore that participants clearly understand the full implications of using ISDA Definitions.

Also it is important that, once ISDA Definitions are adopted, Confirmations are produced that are consistent with them. Examples of these can be found at the rear of each of the ISDA Definitions booklets.

Copies of ISDA Definitions booklets are available from ISDA. Order forms are available on www.isda.org.

[U1.05] Use of Australian Addenda no longer recommended

AFMA recommends no longer including Australian Addenda No's 1 to 12 in ISDA Master Agreements. The provisions of the Australian Addenda are now either out-of date, considered unnecessary, included in ISDA Definitions booklets, or included in the new clauses referred to below. The reasons for no longer recommending the use of each Australian Addendum are explained in Schedule 1 to this update ([U1.09]).

AFMA recognises that it may not be possible or practical to seek to amend existing ISDA Master Agreements by deleting the Australian Addenda and adding extra clauses to Part 5 of the Schedule. AFMA also recognises that some participants may create operational difficulties if they adopted the new approach with some, but not all, counterparties (eg it may mean having to use different types of confirmations). As a result, AFMA recommends that each participant separately considers its own position to determine the approach it wants to adopt as a result of those recommendations. An amendment to remove Australian Addenda from an existing Master Agreement and incorporate new clauses in Part 5 could be effected by way of letter agreement.

[U1.06] Use of PSA/ISMA Global Master Repurchase Agreement

Australian Addendum No. 9 - Reciprocal Purchase Transactions is no longer commonly used. Instead the PSA/ISMA Global Master Repurchase Agreement is the commonly used master agreement for "repo" transactions. This is partly because the Reserve Bank of Australia uses that Agreement for Repos it enters into.

Part 26 of the Guide contains detailed commentary on the PSA ISMA Global Master Repurchase Agreement.

[U1.07] New clauses for Schedule to ISDA Master Agreement

Some of the provisions contained in the Australian Addenda are not included in the ISDA Definitions booklets or the Australian Market Conventions and could still be relevant for some participants. These are provisions dealing with:

- FRA calculations;
- Confirmations of transactions which are usually confirmed using abbreviated confirmations; and
- Time for determining the Spot Rate.

AFMA recommends that the clauses be included either in Confirmations or the Schedule to the ISDA Master Agreement. Suggested clauses (together with commentary on them) are contained in Schedule 2 to this Update [U1.10].

[U1.08] Particular warnings

Here are warnings about two specific issues:

- participants who base their bond settlement amounts on the concept of yield will need to insert special provisions in their Confirmations; and
- whilst use of the Bullion Definitions removes the need for much of Australian Addendum No. 11 - Commodity Transactions, the Bullion Definitions do not cover as wide a range of commodities as Australian Addendum No. 11. If a participant wants to enter into a Bullion Transaction (gold, silver, platinum, palladium), it can incorporate the 1997 ISDA Bullion Definitions. If a participant wants to enter into a Commodity Transaction (other than for precious metals), it can incorporate the 1993 ISDA Commodity Definitions and the 2000 Supplement. In both instances, parties should consider the implications of incorporating the Definitions and should consider whether any additional clauses or amendments to those Definitions should be incorporated into the Schedule or Confirmations. For example, while the 1993 ISDA Commodity Definitions cover a wide range of types of commodity, they do not cover all the types of transactions that are covered by Australian Addendum No.11 (or in the case of bullion, the 1997 ISDA Bullion Definitions). This can be dealt with by either incorporating the 1997 ISDA Bullion Definitions (with appropriate amendments) or adding to the relevant Confirmation the provisions from the Addendum that it wants to retain.

This update does not purport and should not be considered to be a guide to or explanation of all relevant issues or considerations in a particular transaction or contractual relationship. Parties should therefore consult with their legal advisers and any other adviser they deem appropriate before using this update or any ISDA standard documentation. AFMA assumes no responsibility for any use to which any of this update may be put.

[U1.09] Schedule 1 - Why does AFMA no longer recommend using Australian Addenda 1-12?

[U1.09A] AUSTRALIAN ADDENDUM No. 1 - INTEREST RATE CAPS, COLLARS AND FLOORS

(a) **Paragraph (1)**. Redundant. Covered by Article 6 of the 2000 Definitions.

(b) **Paragraphs (2), (3) and (4)**. These set out the Australian "FRA Basis" calculation method for calculating the Floating Amount. The calculation methods differ from the method set out in Section 8.4(b) and Article 6 of the 2000 Definitions. If parties want to retain the discounting provisions for caps, collars and floors (which would be expected for AUD caps, collars and floors in the Australian market), then a suggested provision is set out in paragraph [U1.10B] to this update which provides for calculating amounts on the FRA Basis.

(c) **Paragraph (5)**. This paragraph dealt with the possibility that a Fixed Rate Payment Date, originally understood to be a Business Day, could unexpectedly become a non-Business Day. It does not have an equivalent in the 2000 Definitions. International documentation practice is not to provide a specific formula for the adjustment and AFMA does not believe that the risk justifies Australian ISDAs taking a different approach.

(d) **Paragraph (6)**. Redundant. As noted in paragraphs I.A.4 and II.G.4 of the User's Guide to the ISDA Master Agreement, equivalent wording is already included in the 1992 ISDA Master Agreement definition of Market Quotation.

[U1.09B] AUSTRALIAN ADDENDUM No. 2 - SWAPTIONS

(a) **Paragraph (1)**. No longer needed because a more comprehensive cash settlement valuation and payment provision is contained in Section 17.2 of the 2000 Definitions. However, those provisions will not produce the same result as Paragraph (1) and parties must take care to understand the means of determining the cash settlement amount contained in the 2000 Definitions.

(b) **Paragraph (2).** This paragraph dealt with the possibility that a Premium Payment Date or Cash Settlement Payment Date, originally understood to be a Business Day, could unexpectedly become a non-Business Day. It does not have an equivalent in the 2000 Definitions. International documentation practice is not to provide a specific formula for the adjustment and AFMA does not believe that the risk justifies Australian ISDAs taking a different approach.

(c) **Paragraph (3).** Unnecessary. International documentation practice is not to provide for this information in the Schedule and AFMA does not believe that the risk justifies Australian ISDAs taking a different approach.

(d) **Paragraph (4).** Unnecessary. Section 12.2 of the 2000 Definitions provides for oral or written exercise of an option (with oral exercise to be followed with a written confirmation). However, if parties want a different process (eg always written exercise), this can be specified in the Confirmation.

(e) **Paragraph (5).** Unnecessary. Section 12.1(a) of the 2000 Definitions effectively covers this by providing for the Exercise Period to be between the Commencement Date (which will default to the first Premium Payment Date if not specified otherwise) and the Latest Exercise Time on the Expiration Date. If a party wants the Exercise Period to start on the Trade Date, then the Trade Date should be specified in the relevant Confirmation as the Commencement Date.

(f) **Paragraph (6).** Unnecessary. Failure to pay premium constitutes an Event of Default. Section 2(a)(iii) of ISDA Master Agreement would then operate.

(g) **Paragraph (7).** Redundant. As noted in paragraphs I.A.4 and IIG.4 of the User's Guide to the ISDA Master Agreement, equivalent wording is already included in the 1992 ISDA Master Agreement definition of Market Quotation.

[U1.09C] AUSTRALIAN ADDENDUM No. 3 - BOND OPTIONS

Care! - References to Bond Option Definitions in this commentary means the 1997 ISDA Government Bond Option Definitions. These may not be appropriate for options over non-government bonds.

(a) **Paragraph (1) Definitions**. The definitions of "Put" and "Call" are redundant. Equivalent definitions are in Section 2.4 of the Bond Option Definitions.

The definitions of "Physical Settlement Amount" and "Cash Settlement Amount" are not contained in the Bond Options Definitions. However, Section 6.3(b) and Section 7.3(c) of the Bond Option Definitions provide for more generic calculations of "Bond Payment" and "Spot Price". Parties must take care to understand the commercial effect of the Bond Options Definitions provision.

(b) **Paragraph (2)**. This paragraph dealt with the possibility that a Premium Payment Date or Cash Settlement Payment Date, originally understood to be a Business Day, could unexpectedly become a non-Business Day. It does not have an equivalent in the 2000 Definitions. International documentation practice is not to provide a specific formula for the adjustment and AFMA does not believe that the risk justifies Australian ISDAs taking a different approach.

(c) **Paragraph (3).** Unnecessary. International documentation practice is not to provide for this information in the Schedule and AFMA does not believe that the risk justifies Australian ISDAs taking a different approach.

(d) **Paragraph (4).** Unnecessary. Section 12.2 of the 2000 Definitions provides for oral or written exercise of an option (with oral exercise to be followed with a written confirmation). However, if parties want a different process (eg always written exercise), this can be specified in the Confirmation.

(e) **Paragraph (5).** Unnecessary. Section 12.1(a) of the 2000 Definitions effectively covers this by providing for the Exercise Period to be between the Commencement Date (which will default to the first Premium Payment Date) and the Latest Exercise Time on the Expiration Date. If a party wants the Exercise Period to start on the Trade Date, then the Trade Date should be specified in the relevant Confirmation as the Commencement Date.

(f) **Paragraph (6).** Unnecessary. Failure to pay premium constitutes an Event of Default. Section 2(a)(iii) of ISDA Master Agreement would then operate.

(g) **Paragraph (7).** Redundant. As noted in paragraphs I.A.4 and II.G.4 of the User's Guide to the ISDA Master Agreement, equivalent wording is already included in the 1992 ISDA Master Agreement definition of Market Quotation.

[U1.09D] AUSTRALIAN ADDENDUM No. 4 - CURRENCY OPTIONS

(a) **Paragraph (1)**. Under section 3.5(d) of the 1998 ISDA FX and Currency Option Definitions the default Business Day Convention for the Expiration Date is the Following Business Day Convention. If a participant wants to change this, this can be done in the Schedule of the Master Agreement or in the Confirmation.

(b) **Paragraph (2)**. Unnecessary. International documentation practice is not to provide a mechanism for the adjustment and AFMA does not believe that the risk justifies Australian ISDAs taking a different approach.

(c) **Paragraph (3).** Unnecessary. Parties should take care only to include terms intended to have contractual effect in their Confirmations.

(d) **Paragraph (4).** Unnecessary. Failure to pay premium constitutes an Event of Default. Section 2(a)(iii) of ISDA Master Agreement would then operate.

(e) **Paragraph (5).** Unnecessary. This provision is intended to apply to a specific style of transaction where the premium payment is deferred until after the Exercise Date. In most cases the non payment of the premium will amount to an Event of Default such that the seller will not have to pay the Settlement Amount under Section 2(a)(iii) of the ISDA Master Agreement. In other cases (eg when the Settlement Date is less than 3 Local Business Days after the Premium Payment Date) specific reference should be made in the relevant Confirmation.

(f) **Paragraph (6).** Unnecessary. Although this is not contained in the FX Definitions, it is possible for parties wanting to provide for partial exercise to adopt a mechanism similar to that contained in Section 12.3 of the 2000 Definitions (additional drafting will be required - this could be inserted in a Confirmation).

(g) **Paragraph (7).** This paragraph dealt with the possibility that a Premium Payment Date or day for paying a surrender premium, originally understood to be a Business Day, could unexpectedly become a non-Business Day. It does not have an equivalent in the 2000 Definitions. International documentation practice is not to provide a specific formula for the adjustment and AFMA does not believe that the risk justifies Australian ISDAs taking a different approach.

(h) **Paragraph (8).** Unnecessary. International documentation practice is not to provide for this information in the Schedule and AFMA does not believe that the point justifies Australian ISDAs taking a different approach.

(i) **Paragraph (9).** Unnecessary. Parties should consider the range of possibilities contained in Section 3.7(c) of FX Definitions.

(j) **Paragraph (10).** In Section 1.16(e) of the 1998 FX and Currency Option Definitions, Spot Rate (being the Settlement Rate to be compared with the Strike Price to determine an In-the-Money-Amount) is defined as a rate determined in accordance with the Settlement Rate Option or (if there is no Settlement Rate Option) in good faith and in a commercially reasonable manner by the Calculation Agent. It is not made clear in Section 1.16(e) the time for determining the Spot Rate. Paragraph (10) was included to make this time clear. If the parties want to clarify the time for determining the Spot Rate, then a suggested provision is set out in [U1.10C].

(k) **Paragraph (11).** Unnecessary. Its operation is dependent on the parties' agreement. If this agreement is reached, then the original transaction can simply be amended.

(l) **Paragraph (12).** Unnecessary. However, parties should take care to understand the application of Section 3.6(c) of the FX Definitions which provides that Automatic Exercise applies unless the participants otherwise agree. If participants do not want Automatic Exercise to apply, they can specify this in the Confirmation. The comments on paragraph (10) above in relation to the Spot Rate apply here too, ie if the parties want to clarify the time for determining the Spot Rate, then a suggested provision is set out in [U1.10C].

(m) **Paragraph (13).** The designation by paragraph (13)(a) of any currency option as a Transaction under the ISDA Master Agreement is **not** addressed by ISDA Definitions. Parties should carefully consider whether they require such a clause (it would be required if short form confirmations are used that do not specifically identify the transaction as a "Transaction"). Additional Paragraph (a) at [U1.10A] of this update provides suggested wording for an equivalent of Paragraph (13)(a). Parties wanting to use such a clause should include it in Part 5 of the Schedule to their ISDA Master Agreement.

Paragraph (13)(b) is unnecessary due to the way in which "Confirmation" is defined in the ISDA Master Agreement.

Paragraph (13)(c) is not necessary if the relevant ISDA Definitions are expressly incorporated either in Confirmations or the Schedule to the ISDA Master Agreement. However, if they are not expressly incorporated, parties should carefully consider whether they require such a clause. Additional Paragraph (b) at [U1.10A] of this update provides suggested wording for an equivalent of this paragraph. Parties wanting to use such a clause should include it in Part 5 of the Schedule to their ISDA Master Agreement.

Paragraph (13)(d) Unnecessary. The reference to "Option" is redundant since the introduction of the 1998 FX and Currency Option Definitions. It was included in an earlier version of this Addendum when certain Definitions in Article 8 of the 1991 ISDA Definitions relied on a transaction being an Option. The reference to "Transaction" is unnecessary in light of Section 1.26 of the 1998 FX and Currency Option Definitions.

[U1.09E] AUSTRALIAN ADDENDUM No. 5 - FOREIGN EXCHANGE TRANSACTIONS

(a) **Paragraph (1).** The designation by paragraph (1) of any foreign exchange transaction as a Transaction under the ISDA Master Agreement is **not** addressed by ISDA Definitions. Parties should carefully consider whether they require such a clause. Additional Paragraph (a) at [U1.10A] of this update provides suggested wording for an equivalent of this paragraph. Parties wanting to use such a clause should include it in Part 5 of the Schedule to their ISDA Master Agreement.

(b) **Paragraph (2)**. This is not necessary if the relevant ISDA Definitions are expressly incorporated either in Confirmations or the Schedule to the ISDA Master Agreement. However, if they are not expressly incorporated, parties should carefully consider whether they require such a clause. Additional Paragraph (b) at [U1.10A] of this update provides suggested wording for an equivalent of this paragraph. Parties wanting to use such a clause should include it in Part 5 of the Schedule to their ISDA Master Agreement.

(c) **Paragraph (3).** Unnecessary. International documentation practice is not to specifically deal with this in the ISDA Master Agreement and AFMA does not believe that the point justifies Australian ISDAs taking a different approach.

(d) **Paragraph (4).** Unnecessary due to the way in which "Confirmation" is defined in the ISDA Master Agreement.

[U1.09F] AUSTRALIAN ADDENDUM No. 6 - A$ FORWARD RATE AGREEMENTS

(a) **Paragraph (1)**. The designation by paragraph (1) of any A$FRA as a Transaction under the ISDA Master Agreement is **not** addressed by ISDA Definitions. Parties should carefully consider whether they require such a clause. Additional Paragraph (a) at [U1.10A] of this update provides suggested wording for an equivalent of this paragraph. Parties wanting to use such a clause should include it in Part 5 of the Schedule to their ISDA Master Agreement.

(b) **Paragraph (2)**. Unnecessary. The 2000 ISDA Definitions contain equivalents.

Care! If FRAs are confirmed through Austraclear, parties should consider whether to include a clause in their Schedule incorporating a dictionary of comparative terms. See Schedule 3 to this update (see [U1.11]) for a list of comparative terms and [6.35] for an example of a letter acknowledging that transactions may be confirmed through Austraclear ([6.35] relates to swaps and would need to be amended to cover FRAs).

The "Settlement Sum" definition was incorporated into the Addendum to reflect the method normally used in Australia and New Zealand for calculating AUD FRAs and NZD FRAs. The "Settlement Sum" definition is not equivalent to "FRA Amount" in the 2000 ISDA Definition (The 2000 ISDA Definitions use the "swap basis" calculation method). The suggested clause in [U1.10B] of this update sets out a suggested additional clause which can be inserted in a Confirmation or the Schedule to an ISDA Master Agreement when parties want to continue to use the "Settlement Sum" formula.

(c) **Paragraph (3).** It appears that there may be some variances in practice in calculating the Interest Settlement Rate when it is AUD-BBR-BBSW if the Calculation Period is other than 1, 2, 3, 4, 5 or 6 months. AFMA recommends that parties clarify in their confirmations or elsewhere when the Reset Date is to occur and what Designated Maturity is to apply depending on the length of the Settlement Period.

(d) **Paragraph (4).** Unnecessary. Covered by Section 3.6 of the 2000 Definitions.

(e) **Paragraph (5).** Unnecessary. The suggested clause at [U1.10B] incorporates this wording.

(f) **Paragraph (6).** Unnecessary. If participants want to specify the method of payment, this can be done in the Confirmation or by standing payment instructions.

(g) **Paragraph (7).** Paragraph (7)(a) is unnecessary due to the way in which "Confirmation" is defined in the ISDA Master Agreement.

Paragraph (7)(b) is not necessary if the relevant ISDA Definitions are expressly incorporated either in Confirmations or the Schedule to the ISDA Master Agreement. However, if they are not expressly incorporated, parties should carefully consider whether they require such a clause. Additional Paragraph (b) at

[U1.10A] of this update provides suggested wording for an equivalent of this paragraph. Parties wanting to use such a clause should include it in Part 5 of the Schedule to their ISDA Master Agreement.

Paragraph (c) and (d) are **not** addressed by the ISDA Definitions. See comments at [U1.09F](b) under the paragraph headed **Care!**.

[U1.09G] AUSTRALIAN ADDENDUM No. 7 - FORWARD RATE BILL AGREEMENTS

Unnecessary. The same reasons apply as for Addendum No.6. Also it appears that these types of transactions are entered into only rarely and it is no longer considered appropriate to provide industry standard terms for them.

[U1.09H] AUSTRALIAN ADDENDUM No. 8 - SYNTHETIC AGREEMENTS FOR FORWARD EXCHANGE

Unnecessary. This Addendum has been used only rarely. Provisions addressing non-deliverable foreign exchange transactions are contained in the FX Definitions. However, these are different from those contained in this Addendum and parties should take care to understand the operation of the FX Definitions provisions before using them.

[U1.09I] AUSTRALIAN ADDENDUM No. 9 - RECIPROCAL PURCHASE TRANSACTIONS

No longer recommended because the majority of market participants entering into these transactions use the PSA/ISMA Global Master Repurchase Agreement.

[U1.09J] AUSTRALIAN ADDENDUM No. 10 - NETTING

(a) **Paragraph (1)**. The amendment to Section 1(c) is no longer required because as described in [2.08] of [23.02], the Netting Act does not require a “close-out netting contract” to have “single agreement” wording. As further noted in [2.23] of [23.02] such wording is not required to prevent “cherry picking” of favourable transactions by a liquidator of a party to an ISDA Master Agreement.

(b) **Paragraph (2)**. [2.22] of [23.02] explains that netting will still be available if a party purports to assign its rights under Transactions. As a result, the paragraph (g) representation is no longer required for ISDA Master Agreements. This is not to say that parties are now free to purport to assign or create other interests in Transactions. Any attempt to do so is now subject to the Netting Act and anyone who purports to take such an interest is liable to find, because of the operation of the Netting Act, that it has acquired nothing.)

[2.24] of [23.02] explains that netting under the Netting Act will take place in respect of the same “close-out netting contract” regardless of each party’s capacities in respect of particular Transactions. For this reason the paragraph (h) representation is no longer required. But note the comment in [2.24] of [23.02] about the importance of ensuring that there is “separate agreement” wording where a single ISDA Master is used to document a number of different relationships (eg trading by an investment manager).

(c) **Paragraph (3)**. This undertaking deals with the same issue which is commented on above in relation to the previously suggested Section 3(h). See [U1.09J](b).

(d) **Paragraph (4)**. We consider that the previously recommended Section 5(a)(ii)(2) need not be inserted because, as discussed in (b) above, it is not a condition of the effectiveness of netting under the Netting Act that no purported assignment of the Transactions has taken place.

(e) **Paragraph (5)**. This amendment is no longer needed to protect netting rights but parties may want to consider retaining it to protect their credit exposure position. It is now a recommended optional clause - see [18.21].

(f) **Paragraph (6)**. This paragraph stated that the Second Method will apply to a Section 6(e) calculation. Although we consider that it is critically important for parties to agree to use the Second Method (which provides for full two way payments) rather than the First Method (which provides for only limited two way payments), this issue is addressed in [3.17] to [3.24] and [5.14].

(g) **Paragraph (7)**. As mentioned above in [U1.09J](b) and (d), the creation of third party rights in respect of Transactions does not affect netting under the Netting Act. Consequently, this paragraph is no longer required.

(h) **Paragraph (8)**. This consequential amendment to the amendment which was set out in the last sentence of paragraph (1) of the Addendum is no longer required.

[U1.09K] AUSTRALIAN ADDENDUM No. 11 - COMMODITY TRANSACTIONS

Some of the provisions are not required because similar provisions are contained in the 1997 ISDA Bullion Definitions. Parties must take care if these provisions are not incorporated into their transactions (for example, in entering into non-bullion commodity transactions).

(a) **Paragraph (1)**. The designation by paragraph (1) of any commodity transaction as a Transaction under the ISDA Master Agreement is **not** addressed by ISDA Definitions. Parties should carefully consider whether they require such a clause (it would be required if short form confirmations are used that do not specifically identify the transaction as a "Transaction"). Additional Paragraph (a) at [U1.10A] of this update provides suggested wording for an equivalent of this paragraph. Parties wanting to use such a clause should include it in Part 5 of the Schedule to their ISDA Master Agreement.

(b) **Paragraph (2).** Paragraphs (a) & (b) are unnecessary due to the way in which "Confirmation" is defined in the ISDA Master Agreement.

Paragraph (c). International documentation practice is not to specifically deal with this in the ISDA and AFMA does not believe that the point justifies Australian ISDAs taking a different approach.

Paragraph (d). Unnecessary, provided precious metals transactions are documented under the Bullion Definitions (see Section 1.14 of the Bullion Definitions).

(c) **Paragraph (3).** Paragraph (a) is not necessary if the relevant ISDA Definitions are expressly incorporated either into Confirmations or the Schedule to the ISDA Master Agreement. However, if they are not expressly incorporated, parties should carefully consider whether they require such a clause. Additional Paragraph (b) at [U1.10A] of this update provides suggested wording for an equivalent of this paragraph. Parties wanting to use such a clause should include it in Part 5 of the Schedule to their ISDA Master Agreement.

Paragraph (b) is unnecessary if the Addendum is not incorporated in an ISDA Master Agreement.

Paragraph (c) is unnecessary if the Addendum is not incorporated in an ISDA Master Agreement.

Paragraph (d) is unnecessary if the Addendum is not incorporated in an ISDA Master Agreement.

(d) **Paragraph (4)** Unnecessary. Equivalent terms are in the Bullion Definitions, in particular Articles 3, 4 & 11 and Section 2.2. However, it is important that the ISDA terminology is used in Confirmations.

Main differences with the Bullion Definitions are:

- "Buyer" and "Seller" only used with Bullion Options in the Bullion Definitions;
- there are multiple Bullion Reference Prices (instead of "Spot Price") contained in the Bullion Definitions; and
- there is no special provision relating to floating forward transactions in the Bullion Definitions.

(e) **Paragraph (5).** Unnecessary. There are equivalent terms in the Bullion Definitions in respect of Bullion Options, in particular Articles 2 & 3. However, it is important that the ISDA terminology is used in Confirmations.

(f) **Paragraph (6).** Sub paragraphs (a) & (b) are unnecessary because they are contained in Sections 1.6 and 1.7 and Article 5 of the Bullion Definitions.

Sub-paragraph (c) is **not** contained in the Bullion Definitions. This could be included in the Schedule to a Master Agreement if required. The text is as follows:

> "(#) in addition to the representations contained in Section 3 of this Agreement, each party will be deemed to have represented to the other party at the time it delivers any commodity to the other party pursuant to this Agreement, that it has full legal and beneficial title to that commodity and it delivers the same free and clear of any security interest, claim, lien or encumbrance of any kind;"

Sub-paragraph (d) is **not** contained in the Bullion Definitions. It could be included in the Confirmation of a transaction if specific concerns exist.

Sub-paragraph (e) is **not** included in the Bullion Definitions. It could be included in the Confirmation of a transaction if specific concerns exist.

Sub-paragraph (f) is **not** included in the Bullion Definitions. However, this provision is not considered to be necessary (unless concerns specific to a Transaction exist).

[U1.09L] AUSTRALIAN ADDENDUM No. 12 - NON-A$ FORWARD RATE AGREEMENTS

Unnecessary. The same reasons apply as for Addendum No 6. The suggested provision to be added to the Schedule to a Master Agreement for the calculation of the Settlement Amount for NZD FRAs is contained in the suggested clause at [U1.10B] of this update.

[U1.10] Schedule 2 - Recommended new clauses for Part 5 of Schedule

[U1.10A] Incorporating transactions and ISDA Definitions

Many of the Australian Addenda contain provisions which either:

- incorporate transactions of a particular type to be Transactions under the ISDA Master Agreement; or
- incorporate the relevant ISDA Definitions into the Confirmations of Transactions of a particular type.

These provisions were included as many Confirmations for particular types of transactions, such as FRAs and FX transactions are confirmed using short form confirmations which do not include the usual ISDA introductory wording.

Now that AFMA no longer recommends using the Addenda, AFMA recommends that provisions of this type be added to the Schedule to a Master Agreement if the parties intend to use short form confirmations. The clauses below serve this purpose and allow for the parties to add the relevant types of transactions to the table as necessary.

Clause (b) incorporates only the specified ISDA Definitions and does not of itself automatically incorporate updates of ISDA Definitions. This is because there may be delay before a market participant wants to use a new set of ISDA Definitions, if they are to be used at all. Parties should consider whether they need to refer to other types of transactions (this will depend largely on the types of Confirmations they intend using and whether the confirmations refer to specific ISDA Definitions booklets).

Care! The clauses below have been prepared on the assumption that both clauses (a) and (b) will be included (clause (a) refers to the table in clause (b)).

Suggested clause

"(#) **Application and ISDA Definitions**

(a) **Application.** Every transaction between the parties which is, or is described in its confirmation as being, of the type specified in the table below is a Transaction governed by the terms of this Master Agreement (and not any other master agreement) and forms part of this Master Agreement unless the parties expressly agree in writing that this clause is not to apply. This applies whether or not the parties refer to this Master Agreement or state that the transaction is governed by the terms of any other master agreement when entering into the transaction.

(b) **ISDA Definitions.** The definitions and provisions contained in the respective ISDA Definitions specified below are incorporated into each Confirmation of a Transaction between the parties which is, or described in its Confirmation as being, of the type specified below. If there is an inconsistency between those definitions and provisions and any such Confirmation, the Confirmation prevails.

Types of transactions	***ISDA Definitions***
Currency option transaction or FX transaction	1998 FX and Currency Option Definitions as published by International Swaps and Derivatives Association, Inc., the Emerging Markets Traders Association and the

	Foreign Exchange Committee
Forward rate agreement	2000 ISDA Definitions as published by International Swaps and Derivatives Association Inc.
Forward commodity transaction; spot commodity transaction; commodity option transaction; commodity swap transaction; commodity cap, collar or floor transaction	1993 ISDA Commodity Derivative Definitions as published by International Swaps and Derivatives Association, Inc. as supplemented by the 2000 Supplement
Bullion spot transaction; bullion forward transaction; bullion swap transaction or bullion option transaction	1997 ISDA Bullion Definitions as published by International Swaps and Derivatives Association, Inc. ”

[U1.10B] FRA basis discounting

Certain types of transactions in Australia use a particular formula for the purpose of discounting, these are:

- AUD FRAs
- NZD FRAs
- AUD & NZD Caps, Collars and Floors.

The formula for these transactions was included in the relevant Australian Addenda. AFMA recommends that if market participants intend to enter into these types of Transactions, then a clause incorporating the relevant formulae should be included in the Confirmation or the Schedule.

Suggested wording is contained below where parties intend that the FRA Basis is to be used for all those types of transactions. This is a composite of all of the formulae. Market participants must ensure that it accurately reflects their commercial intentions.

Suggested clause

“(#) **FRA Basis.** Unless expressly agreed otherwise in respect of a particular Transaction, the following provisions apply to any Transaction which is, or is described in its Confirmation to be, an AUD or NZD forward rate agreement (“**FRA**”), or an AUD or NZD rate cap transaction, rate collar transaction or rate floor transaction.

For the purpose of the following provisions, the rate cap part of a rate collar transaction is to be treated as a rate cap transaction and the rate floor part of a rate collar transaction is to be treated as a rate floor transaction.

Despite sections 6 and 8.4(b) of the 2000 ISDA Definitions, on each Payment Date:

(a) in the case of an FRA:

(i) if the Floating Rate exceeds the Fixed Rate, then the Floating Rate Payer must pay the absolute value of the FRA Amount to the Fixed Rate Payer; and

(ii) if the Fixed Rate exceeds the Floating Rate, then the Fixed Rate Payer must pay the FRA Amount to the Floating Rate Payer;

(b) in the case of a rate cap transaction, if the Floating Rate exceeds the Fixed Rate, then the Floating Rate Payer (Seller) must pay the absolute value of the FRA Amount to the Fixed Rate Payer (Buyer). (No corresponding payment is due from the Fixed Rate Payer to the Floating Rate Payer);

(c) in the case of a rate floor transaction, if the Fixed Rate exceeds the Floating Rate, then the Floating Rate Payer (Seller) must pay the FRA Amount to the Fixed Rate Payer (Buyer). (No corresponding payment is due from the Fixed Rate Payer to the Floating Rate Payer).

The "**FRA Amount**" is calculated in accordance with the following formula:

$$CA \ \text{x} \ 36500 \ \text{x} \left[\frac{1}{36500 + (R_1 \ \text{x} \ ND)} - \frac{1}{36500 + (R_2 \ \text{x} \ ND)} \right]$$

where:

CA = Calculation Amount.

R_1 = in the case of an FRA, the Floating Rate on the Payment Date (expressed as a number and not a percentage, eg 8.1875 not 8.1875%), or in the case of a rate cap transaction or a rate floor transaction, the Floating Rate (plus or minus the Spread, if any) calculated disregarding section 6.2(a)(i) and section 6.2(a)(ii) of the 2000 ISDA Definitions.

R_2 = in the case of an FRA, the Fixed Rate (expressed as a number and not a percentage), or in the case of a rate cap transaction or a rate floor transaction, the cap rate or the floor rate respectively.

ND = the actual number of days in the Calculation Period.

Unless otherwise agreed, the Relevant Rate:

(a) in the case of A$ FRAs is "AUD-BBR-BBSW"; and

(b) in the case of NZD FRAs is "NZD-BBR-FRA"."

[U1.10C] Time for determining Spot Rate

It is not made clear in Section 1.16(e) of the 1998 FX and Currency Option Definitions the time for determining the Spot Rate (see [U1.09D] of this update). If parties want to clarify this time they could include the following clause in a Confirmation or the Schedule to an ISDA Master Agreement.

Suggested clause

“(#) **Spot Rate.** The time for determining a Spot Rate for the purpose of Section 1.16(e) of the 1998 FX and Currency Option Definitions published by International Swaps and Derivatives Association Inc is to be determined, for a European option, as at the Expiration Time, and for an American option or a Bermuda option, as at the time when the Notice of Exercise is given.”

[U1.11] Schedule 3 - FRA Dictionary (refer to [U1.09F](b) of this Update)

This shows equivalent terms (in some cases the equivalence is only approximate).

Australian Addenda	2000 ISDA Definitions	ABAFRA terms	Austraclear terms
AUD-BBR-BBSW	AUD-BBR-BBSW		"Y" at the "Use BBSW (Y/N)" item.
Borrower	Fixed Rate Payer		"B" at the "side of the trade" item.
Business Day	Business Day		
Contract Amount	Calculation Amount	Notional Amount, Amount, Face Value	Amount
Contract Currency	Calculation Amount		
Contract Rate	Fixed Rate	Rate	Rate
Deal Date	Trade Date	Contract Date	Deal Date
Designated Maturity	Designated Maturity		
Fixing Date	Reset Date		
FRA	N/A		FRA
FRA BBA Terms	N/A		
Interest Settlement Rate	Floating Rate		
Lender	Floating Rate Payer		"L" at the "side of the trade" item
Maturity Date	Termination Date		Maturity Date
Non-A$ FRA	N/A		
Settlement Date	Payment Date		Settlement Date
Settlement Period	Calculation Period	Contract Period	
Settlement Sum	FRA Amount[1]		Cash Element (being the difference between the Settlement Value and the Specified Value)

[1] This is not an equivalent formula to "Settlement Sum" in Australian Addendum 6. See [U1.10B] of this update for wording for the formula used in "Settlement Sum". See also [U1.09F](b).