



## A NEW MASTER AGREEMENT FOR THE FRENCH DERIVATIVES MARKET

In November 2012, the Structured and Derivative Products team of the Jones Day Paris Office was appointed counsel of the French Banking Federation (*Fédération Bancaire Française*, or “FBF”) on its project to update the French market master agreement for over-the-counter derivatives transactions, which it first published back in 1994 (the “FBF Agreement”).

The FBF is a professional association representing more than 390 French banks, branches or affiliates of foreign banks incorporated in France. The FBF promotes the banking and financial services industry in France and sets out industry positions and proposals to official and regulatory authorities. Its mission also entails keeping members aware of any legal or regulatory developments that may affect their activities.

The purpose of this year’s update is to draw lessons from the financial crises and to address the new obligations imposed by the Regulation (EU) no. 648/2012 of the European Parliament and of the Council of July 4, 2012 on OTC derivatives, central counterparties, and

trade repositories (together with its nine regulatory and implementing technical standards adopted by the European Commission on December 19, 2012, “EMIR”).

The updated FBF Agreement was published on June 25 with a standard schedule, a supplemental agreement enabling the parties to a 2007 FBF Agreement to supplement it with the new provisions of the 2013 version, and EMIR schedules aimed at integrating EMIR requirements into signed FBF Agreements in their 1994, 2001, or 2007 version. The Structured and Derivative Products team also translated the updated FBF Agreement into English.

This *Commentary* presents the main amendments made to the FBF Agreement by the 2013 update. It should be noted that such update addresses only the new requirements imposed by EMIR for over-the-counter derivatives contracts not cleared by a central counterparty. The Structured and Derivative Products team is now closely working with the FBF to publish before the end of 2013 a schedule adapting the

FBF Agreement to the new clearing obligation for standard derivatives contracts identified as such by the European Securities and Market Authority.

Capitalized terms used in this *Commentary*, if not otherwise defined herein and unless the context otherwise requires, shall have the meaning ascribed to them in the FBF Agreement.

## DRAWING LESSONS FROM THE FINANCIAL CRISIS

Major financial institutions' defaults during the financial crisis have shown that, despite the efficiency and robustness of the termination process provided for under the FBF Agreement, some flexibility and clarifications could be introduced by the 2013 update.

**Computation of the Settlement Amount.** Various modifications have been made to Article 8 of the FBF Agreement in order to make the computation of the Settlement Amount easier and more efficient in times of low market liquidity.

**The New Definition of "Replacement Value."** The definition clarifies what was already the case but had been the subject of discussions on the market, that the Party that has obtained various market quotations from prime market participants is free to select those of its choice when determining the Replacement Value.

Moreover, the Party in charge of the computation may now decide to rely instead on market data when determining the Replacement Value, provided that such data are available on databases published by at least two third parties and commonly used by market participants for establishing quotations or valuations.

Such Party may also consider any loss and cost incurred in connection with its terminating, liquidating, or re-establishing any hedge related to one or more terminated Transaction unless the loss or costs have already been taken into account in the above-mentioned market data or quotations.

Finally, such definition provides for a fallback when no quotation or market data can reasonably be obtained for the Termination Date. The Party in charge of the computation will then determine the Replacement Value on the basis of internal sources.

**Taking Account of Liquidity Gains or Costs into the Computation of the Settlement Amount.** Article 8.1.1 of the FBF Agreement now provides that the Party in charge of the computation shall take into account any Liquidity Gain or Cost when determining the Settlement Amount.

"Liquidity Gains" and "Liquidity Costs" are defined in Article 3 as the cost incurred (or the gain generated, as the case may be) by the conclusion and execution of financing transactions aimed at hedging the relevant Party's cash positions resulting from the termination of the Transactions.

## IMPLEMENTING THE NEW EMIR REQUIREMENTS FOR OTC DERIVATIVES CONTRACTS

Various amendments have been made to the FBF Agreement in order to address the new requirements imposed by EMIR for over-the-counter derivatives contracts not cleared by a central counterparty.

**Conclusion of Transactions and Timely Confirmation.** Article 4.2 addresses the new EMIR requirement relating to timely confirmation of over-the-counter derivatives contracts not cleared by a central counterparty and provides that the conclusion of each Transaction must be confirmed in the format and within the deadlines imposed by applicable regulation.

Article 1 of the standard schedule enables the Parties to supplement such Article by providing for a negative consent, i.e., that, in the absence of any objection of a Party within two Business Days following the receipt by such Party of a Confirmation, and save for manifest error, the Parties shall be deemed to have agreed upon the terms of the Confirmation sent by the more diligent Party.

**Representation of the Parties' Status under EMIR.** A new Article 6.2 has been incorporated in the FBF Agreement. It contains an additional representation relating to the Parties' Status under (i) EMIR or (ii) any other applicable regulation imposing the clearing by a central counterparty of one or more Transactions.

Article 7 of the standard schedule lists all the different statuses existing under EMIR, thus enabling each Party to represent, at the time of entering into the FBF Agreement and into each Transaction, that it is either a financial counterparty, a non-financial counterparty, or an exempted counterparty, etc.

Finally, Article 6.2 provides that the Parties shall inform each other of any change affecting their Status and the reasons of such change.

A misrepresentation or a breach under Article 6.2 does not constitute an Event of Default, but Articles 7.2.1.3 and 7.2.2.3 (further detailed below) provide for specific remedies if the clearing mandate is not complied with as a result of such misrepresentation or breach.

**Clearing by a Central Counterparty.** Article 11.13 provides that if one or more Transactions must be cleared by a central counterparty pursuant to applicable laws or regulations or an agreement between the Parties, such Parties agree to the conclusion and execution of appropriate supporting documentation in order to continue and clear the relevant Transactions within applicable deadlines. If the Transactions could not be cleared within the applicable time frame, a new Change of Circumstances (Article 7.2.1.3) enables the Parties to terminate such relevant Transactions.

One should note that upon the occurrence of such Change of Circumstances, the new Article 7.2.2.3 distinguishes between the two following situations:

- If such Change of Circumstances results from one Party's failure to notify its Status or any change thereto in accordance with Article 6.2, this Party will be the only Affected Party and the other Party shall be entitled to withhold performance of its payment and Delivery obligations and terminate the sole affected Transactions; or

- If such Change of Circumstances occurs for any other reasons, then the two Parties will be deemed to be affected and as such will be entitled to withhold performance of their payment and Delivery obligations and calculate the Settlement Amount as the result of the termination of the sole affected Transactions.

**Risk Mitigation Techniques.** Articles 11.9 to 11.12 now provide that the Parties will comply with the requirements imposed by EMIR relating to (i) transaction reporting, (ii) portfolio reconciliation, compression, and dispute resolution, (iii) marking-to-market of Transactions, and (iv) collateral requirements.

The failure to comply with such risk mitigation techniques will not constitute an Event of Default but may trigger the contractual liability of the relevant Party.

## MISCELLANEOUS

Various drafting amendments and changes have also been made to the FBF Agreement, notably relating to the following.

**Scope of the FBF Agreement.** The scope of the FBF Agreement has slightly been extended by the 2013 update to all transactions on forward financial instruments that benefit from the French close-out and netting regime. The FBF Agreement therefore applies not only to transactions on forward financial instruments, as such instruments are defined in Articles L. 211-1-III and D. 211-1 A of the French Monetary and Financial Code (implementing Directive 2004/39/EC on market in financial instruments), but also to any other forward financial contracts not mentioned in Article L. 211-1-III but covered by the French close-out and netting regime and mentioned in Article L. 211-36 II of such code (see the new definition of "Transaction").

**Payment Netting.** Before the 2013 update, Parties had to elect whether or not they wanted the payment netting provision of Article 5.3 to apply.

The new wording of such Article now provides that the Parties agree to set off their reciprocal payment or Delivery obligations occurring on the same day under the same Transaction and may agree to do so for obligations falling due on the same date under a group of Transactions.

In other words, payment netting on a transaction-by-transaction basis will now apply by default, and the Party will only have to elect, in Article 2 of the standard schedule, if they want payment netting to apply on a multitransactional basis.

**Assignment to a Third Party.** A new paragraph has been inserted in Article 11.4, to clarify that each Party is free to transfer, assign, or grant as a security interest or as a guarantee to a third Party all or any part of its claim corresponding to the Settlement Amount, without the prior consent of the other Party.

**Representations.** The FBF Agreement now provides for a broader no-agency representation (Article 6.1.2), and the nonreliance representation has been substantiated in order to limit the scope of the advisory duties of a bank to its client as such duties are currently defined by regulation and case law (Article 6.1.9).

**No Hierarchy Among Events of Default.** The new version clarifies that, should one factual event or series of circumstances occurring in respect of one Party qualify under several Events of Default, the Non Defaulting Party can, in its sole and absolute discretion, decide on the basis of which of such Events of Default to terminate the master agreement, and there should be no prevalence of one of them above the others.

As opposed to other market master agreements, the FBF Agreement does not require that the Event of Default be continuing for it to be the basis of a termination. The occurrence of such Event of Default is sufficient to provide the Non Defaulting Party with the right to terminate, unless it is deemed to have waived such right, expressly or by continuing to perform the contract.

## LAWYER CONTACTS

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