



INTERNATIONAL SECURITIES MARKET ASSOCIATION

By e-mail

December 10, 2004
TH/AS/ys

To the members of the Association

New recommendation 2 by the international repo committee regarding fails in negative interest rate repos (subsection G in section 1000 of ISMA's rules and recommendations)

Dear members

1. The problem

ISMA's European repo committee (the ERC committee) recently raised concerns in relation to the treatment of negative interest rate repos* and in particular, the consequences of a failure by the seller to deliver the purchased securities on the purchase date.

The Global Master Repurchase Agreement (GMRA) does not provide expressly for negative interest rates and assumes that interest rates will be positive.

Under the GMRA, repo interest runs from the purchase date until the transaction is terminated.

Where the interest rate for a transaction is negative, this provides an incentive to the seller to fail to deliver the purchased securities because, arguably, it will nevertheless receive interest on the purchase price.

* i.e. a repo in which the repo rate is less than zero so that, contrary to the normal position under which the seller pays interest on the amount of the purchase price, the buyer of the securities must pay interest to the seller for the duration of the transaction.

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2. The solution

In the light of this, and on the basis of the conclusions reached in discussions between ISMA's market practices committee (MPC) and a delegation of the ERC committee the international repo committee resolved on November 16, 2004 to approve a new recommendation to be incorporated in subsection G of section 1000 in ISMA's rules and recommendations to the effect that market participants who wish to enter into a repo transaction (whether a repurchase or a buy/sell back transaction) in which the rate of interest payable by the seller on the purchase price will be negative, should agree that if the repo seller fails to deliver the purchased securities on the purchase date then -

- (i) the buyer may terminate the transaction (and this right should continue for every day that the seller fails to deliver); and
- (ii) for every day that the seller fails to deliver the purchased securities the repo rate should be zero.

At its meeting on December 10, 2004 the board approved the new recommendation.

3. The new recommendation in light of EU and UK competition law

In line with ISMA's longstanding policy and in order to ensure that the new recommendation does not infringe EU or UK competition law, the new recommendation was submitted to ISMA's outside legal counsel who have confirmed that the new recommendation does not raise EU or UK competition law concerns.

4. The effective date of the new recommendation

The new recommendation will become effective on January 1, 2005.

5. The wording of the new recommendation

The new recommendation is attached to this circular as a separate document.

6. Update to ISMA's rule book

The current version of ISMA's rule book on ISMA's web site will be replaced with an amended version incorporating the new recommendation.

Yours sincerely

A handwritten signature in black ink that reads "John L. Langton". The signature is written in a cursive style with a long horizontal line extending from the bottom of the "n" across the signature.

John L. Langton
Chief Executive and
Secretary General

A handwritten signature in black ink that reads "Thomas Hunziker". The signature is written in a cursive style with a long horizontal line extending from the bottom of the "r" across the signature.

Thomas Hunziker
General Counsel

Attachment

Recommendation 2 Negative interest rate transactions

The international committee recommends that market participants who wish to enter into a repo transaction (whether a repurchase transaction or a buy/sell back transaction) in which the rate of interest payable by the seller on the purchase price will be negative agree that if the repo seller fails to deliver the purchased securities on the purchase date then -

- (i) the buyer may terminate the transaction (and this right should continue for every day that the seller fails to deliver); and
- (ii) for every day that the seller fails to deliver the purchased securities the repo rate should be zero

(the “International Repo Committee recommendation for negative interest rates”).

Where market participants have entered into the PSA/ISMA Global Master Repurchase Agreement (1995 version) or the TBMA/ISMA Global Master Repurchase Agreement (2000 version) (each, the GMRA) the GMRA should be amended to incorporate the provisions set out below. Users of the GMRA may incorporate the provisions into the GMRA itself as a supplemental term in part 2 of Annex I or, alternatively, on a transaction-by-transaction basis by incorporating the provisions into the confirmation of relevant transactions. Where the provisions are incorporated into a confirmation, they can be included in full or be incorporated by reference by the use of a phrase such as “negative interest rates: International Repo Committee recommendation shall apply”.

“The parties agree that the following provisions shall apply in relation to any transaction in respect of which the Pricing Rate is negative.

- (a) The definition of “Pricing Rate” in paragraph 2[(ee)]* [(jj)]⁺ is amended by adding the phrase “(which may be a negative number)” after “percentage rate”.
- (b) Paragraph 10 [(e)]* [(g)]⁺ is amended by adding the following at the end of that paragraph -

“If the Pricing Rate agreed for the Transaction in question is negative, the Pricing Rate for that Transaction shall be deemed to be zero for as long as such failure continues. ””

* GMRA 1995

+ GMRA 2000