
User's Guide to the 2002 ISDA[®] Novation Agreement

ISDA[®]

INTERNATIONAL SWAPS AND DERIVATIVES ASSOCIATION, INC.

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INTRODUCTION

This User's Guide is intended to highlight a number of points relating to the provisions of the 2002 ISDA Novation Agreement (the "Novation Agreement"), published by the International Swaps and Derivatives Association, Inc. ("ISDA"). In particular, it is meant to focus attention upon the choices and variations which parties entering into a Novation Agreement may wish to consider. The footnotes in the Novation Agreement refer parties to specific sections of this User's Guide.

Capitalized terms used in this User's Guide and not defined herein are intended to have the meanings given such terms in the Novation Agreement or in the 1992 ISDA Master Agreement, as the context may require.

THIS USER'S GUIDE DOES NOT PURPORT TO BE, AND SHOULD NOT BE CONSIDERED TO BE, A GUIDE TO OR EXPLANATION OF ALL ISSUES AND OTHER CONSIDERATIONS RELEVANT TO DECIDING WHETHER TO ENTER INTO A NOVATION AGREEMENT, INCLUDING RELEVANT ENFORCEABILITY, REGULATORY, TAX, ACCOUNTING AND OTHER CONSIDERATIONS. EACH PARTY SHOULD CONSULT WITH ITS LEGAL AND TAX ADVISERS AND ANY OTHER ADVISER IT DEEMS APPROPRIATE PRIOR TO USING ANY STANDARD ISDA DOCUMENTATION. ISDA ASSUMES NO RESPONSIBILITY FOR ANY USE TO WHICH ANY OF ITS DOCUMENTATION OR ANY DEFINITION OR PROVISION CONTAINED THEREIN MAY BE PUT.

USER'S GUIDE TO THE 2002 ISDA NOVATION AGREEMENT

1. *Confirmations Prior to Execution of a 1992 ISDA Master Agreement.*

Where the Transferee and the Remaining Party have not yet entered into a 1992 ISDA Master Agreement, the following changes may be made:

Replace subparagraph 2.(c) with the following paragraph:

"the Transferee and the Remaining Party shall enter into one or more Confirmations specifying the terms of each New Transaction, which Confirmations shall include the paragraph specified in note 2 to Exhibit I to the 2000 ISDA Definitions as may be amended by the parties; provided, however, that any failure on the part of either the Transferee or the Remaining Party to enter into such Confirmations will not affect the rights and obligations of the Transferor pursuant to this Novation Agreement, and the offices of the Remaining Party and the Transferee for purposes of each New Transaction shall be [[] and [], respectively]/[as specified in the Annex] and the office of the Transferor for purposes of the Old Transaction shall have been [] [as specified in the Annex]."

2. *Dating of the Novation Agreement.*

The Novation Agreement is designed for the insertion of three types of dates, the heading date "as of" which the Novation Agreement is made (which should be the date the parties actually agree to the novation, whether orally or otherwise), the "Novation Date" (which is the date or dates on which each New Transaction between the Remaining Party and the Transferee functionally begins) and the dates of actual signature of the Novation Agreement (to be indicated on the signature page).

3. *Apportionment of Responsibility.*

Section 2 of the Novation Agreement, in subparagraphs (a) and (b), contains language apportioning responsibility for payment and delivery obligations between the Remaining Party and the Transferor on the one hand and the Remaining Party and the Transferee on the other. The key concept in this apportionment is whether or not a payment or other obligation is due and payable or due to be performed on or prior to the Novation Date. This concept is in common use, however, the parties may wish to consider other possibilities reflective of concepts that may be embedded in an Old Transaction. For example, if an Old Transaction provides for delayed payment (i.e., following some interval after the last day of the calculation period), the parties may wish to insert the following in subparagraph (a) immediately following the word "Date" in line 5 and in subparagraph (b) immediately following the word "Date)" in line 7:

"or due and payable or due to be performed after the Novation Date but stated in the relevant Old Confirmation to have accrued with respect to a calculation period (however defined) ended on or prior to the Novation Date"

If an Old Transaction calls for early payment the parties may wish instead to consider the following as a new subparagraph (d) of Section 2:

"any payments due and payable or obligations due to be performed on or prior to the Novation Date but stated in the relevant Old Confirmation to have accrued with respect to a calculation period (however defined) ending after the Novation Date shall be paid or performed between the Remaining Party and the Transferee, subparagraphs (a) and (b) above notwithstanding."

The language of Section 2 will be sufficient for many cases. Parties, however, should consider whether the particular features of each Old Transaction to be novated require special treatment in Section 2.

4. Representation Regarding Relationship Between Parties.

Some parties may wish to consider including the following in their Novation Agreement:

"(iv) Each party represents to each of the other parties: --

- (A) **Non-Reliance.** It is acting for its own account, and it has made its own independent decisions to enter into this Novation Agreement and as to whether this Novation Agreement is appropriate or proper for it based upon its own judgment and upon advice from such advisers as it has deemed necessary. It is not relying on any communication (written or oral) of the other parties as investment advice or as a recommendation to enter into this Novation Agreement; it being understood that information and explanations related to the terms and conditions of this Novation Agreement shall not be considered investment advice or a recommendation to enter into this Novation Agreement. No communication (written or oral) received from any of the other parties shall be deemed to be an assurance or guarantee as to the expected results of this Novation Agreement;
- (B) **Assessment and Understanding.** It is capable of assessing the merits of and understanding (on its own behalf or through independent professional advice), and understands and accepts, the terms, conditions and risks of this Novation Agreement. It is also capable of assuming, and assumes, the risks of this Novation Agreement; and
- (C) **Status of Parties.** None of the other parties is acting as a fiduciary for or an adviser to it in respect of this Novation Agreement."

5. Special Transaction and Master Agreement Terms.

A Confirmation, or the Master Agreement of which it is a part, may contain credit or other terms that are relevant to a Transaction, but that the parties do not intend to see replicated in the novated Transaction. As it has not been possible to characterize the range of terms that may be subject to this intention, it is important to note that:

- A. It is the usual expectation of parties that a novated Transaction will become subject to the credit and other terms in the Master Agreement, if any, between the Remaining Party and the Transferee, and
- B. Industry participants are advised to exercise care in using existing Confirmations as the agreed record of the terms of Transactions to be novated, where these Confirmations include terms beyond those usually considered necessary to the particular Transactions documented.

The parties may disapply particular terms of an Old Transaction in a number of different ways, including through specific provision in the Novation Agreement or by specifying the terms of a New Transaction in a New Confirmation.

6. Governing Law.

The parties may elect either English law or New York law as the governing law of the Novation Agreement. A convention frequently followed for purposes of simplifying the preparation of the

Novation Agreement is that the governing law of the Novation Agreement be the same as the governing law stated in the New Agreement between the Remaining Party and the Transferee.

7. *Miscellaneous Provisions.*

As the Novation Agreement is a separately executed document, some parties may wish to consider inserting other miscellaneous provisions (for example, a waiver of jury trial) parallel to those that they may customarily choose to have in their Master Agreements. Please see the User's Guide to the 1992 ISDA Master Agreements for discussions of some of these provisions.

8. *Example of Annex Template for Identification of Old Transactions to be discharged in relation to a Rate Swap Transaction or Cross-Currency Rate Swap Transaction.*

The Novation Agreement provides that the parties may identify the Old Transactions by attaching Confirmations or by listing identifying information in an Annex. It is not possible to predict whether summary information contained in any particular case in such an Annex will provide adequately reliable identification of Old Transactions to achieve a binding novation. That said, the attached example is intended to show the sort of information that might be listed in an Annex with respect to a simple interest rate or cross-currency rate swap transaction. Whether or not the information would be sufficient in any given case would depend on a number of factors, including the precise nature of the Transaction in question and the composition of the portfolio of Transactions that may exist between the Transferor and the Remaining Party.

9. *Investigation by Transferee.*

It is vital, of course, for the Transferee to investigate in full the terms of any Transactions that it intends to accept. An Annex successful in identifying Transactions might still omit terms material to the Transferee.

10. *Regulatory Concerns.*

As the Remaining Party and the Transferee enter into New Transactions under the terms of the Novation Agreement, the parties should have regard to the same regulatory responsibilities and considerations which would apply when they are otherwise entering into a new Transaction or relationship with a counterparty.

11. *Drafting Responsibility.*

As the Novation Agreement is a three-party arrangement, there may be some concern about which of the three parties is to draft the document. A convention followed by some to avoid disagreements is to allocate drafting responsibility to the Remaining Party.

