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Drafting Guide

Schedule to the 2002 ISDA Master Agreement

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Schedule to the 2002 ISDA Master Agreement

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This Drafting Guide discusses the Schedule to the 2002 ISDA Master Agreement (the “Master Agreement”), explaining the elections and some of the typical changes made by counterparties. The standard form Master Agreement has fourteen sections and while its terms are subject to negotiation between the parties, no modifications are made within the standard form. All amendments and elections are to be made in the Schedule. For an overview of the Master Agreement please see Overview: The ISDA Master Agreement.

Election Title & Description	Drafting Issues & Analysis
<p>Specified Entities, Part 1(a)</p> <p>The parties each specify a Specified Entity for the purposes of the following:</p> <ul style="list-style-type: none"> • Section 5(a)(v) Default under Specified Transaction • Section 5(a)(vi) Cross Default • Section 5(a)(vii) Bankruptcy • Section 5(b)(v) Credit Event Upon Merger <p>If a party's Specified Entity is subject to one of these events, the other party will have the right to terminate all trades under the Master Agreement even though the Specified Entity is not itself a party to the Master Agreement or a Credit Support Provider thereunder.</p>	<p>Parties may identify as a Specified Entities:</p> <ul style="list-style-type: none"> • All Affiliates; • A Specific list of Affiliates; • The Investment Manager for purposes of Bankruptcy; or • Not Applicable. <p>It is preferable for a party not to have Specified Entities (or have as few Specified Entities as possible).</p>
<p>Specified Transactions, Part 1(b)</p> <p>Specified Transaction is as defined under Section 14 of the Master Agreement, unless the parties provide otherwise in the Schedule.</p> <p>Specified Transactions include derivatives transactions as well as “<i>repurchase transaction, reverse repurchase transaction, buy/sell-back transaction, securities lending transaction, weather index transaction or forward purchase or sale of a security, commodity</i>”.</p> <p>The term Specified Transaction is used in the “Default under Specified Transactions” Event of Default. If a default occurs under a Specified Transaction entered into between a party, its counterparty or the counterparty's Credit Support Provider or Specified Entity, the non-defaulting party will be entitled to declare an Event of Default under the ISDA Master Agreement.</p>	<p>Typically, this definition is not amended, although some dealers may expand the definition to include Specified Transactions entered into between a party and a third party (any arm's length entity). It is preferable to avoid this expansion as it increases a party's chance of default under the Master Agreement.</p>

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<p>Cross Default, Part 1(c)</p> <p>Parties will elect whether the “Cross-Default” provision will or will not apply to each party.</p> <p>A Cross Default is an Event of Default under the Master Agreement that entitles a party to terminate the trades under the Master Agreement when its counterparty, its counterparty's Credit Support Provider or any Specified Entity of its counterparty defaults on a Specified Indebtedness to a <i>third party creditor</i>.</p>	<p>Parties typically elect to apply Cross Default. Parties may negotiate to amend the provision by including:</p> <ul style="list-style-type: none"> • Cross Acceleration. Cross Acceleration requires that the third party creditor accelerate the Specified Indebtedness in order for an Event of Default to be triggered under the Master Agreement. • Administrative Error carve-out. A Cross Default will not be an Event of Default under the Master Agreement, if the failure to pay the Specified Indebtedness was due to an administrative or clerical error and was remedied within an agreed upon number of days. <p>This is one of the most heavily negotiated terms in the Schedule despite the fact that it is unclear how a non-defaulting party would become aware of its counterparty's cross default or cross acceleration.</p>
<p>Threshold Amount, Part 1(c)</p> <p>Parties will be required to establish a Threshold Amount. The Cross Default will not be triggered until the Threshold Amount is met or exceeded.</p> <p>The Threshold Amount is an amount that is equal to or greater than the aggregate principal amount of Specified Indebtedness subject to a default, either alone or together with the amount that is in default.</p>	<p>Parties may sometimes agree to:</p> <ul style="list-style-type: none"> • a fixed amount, e.g., \$10,000,000 • a percentage of shareholder's equity • a percentage of net asset value. <p>Threshold amounts are not necessarily symmetrical.</p>
<p>Specified Indebtedness, Part 1(c)</p> <p>“Specified Indebtedness” will have the meaning specified in Section 14 of this Agreement, unless the parties provide otherwise in the Schedule.</p> <p>Specified Indebtedness is an “obligation (whether present or future, contingent or otherwise, as principal or surety or otherwise) in respect of borrowed money.”</p>	<p>Dealers often want to expand the definition to include Specified Transactions entered into by a counterparty with third parties. As with the definition of Specified Transactions, expanding this definition increases a party's chances of default.</p> <p>Banks may look to carve-out from the definition of Specified Indebtedness any “deposit received in the ordinary course of business”. This is because when someone makes a cash deposit to a deposit account, that person relinquishes legal title to the cash and instead obtains a right to the return of the cash (the cash deposit becomes a liability of the bank and therefore “Specified Indebtedness”).</p>

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<p>Credit Event Upon Merger, Part 1(d)</p> <p>Parties will elect whether “Credit Event Upon Merger” will apply to a party, any Credit Support Provider(s) in addition to any Specified Entities specified in Part 1(a).</p> <p>A Credit Event Upon Merger is a Termination Event, rather than an Event of Default under the Master Agreement. If applicable, a party will be entitled to terminate the trades under the Master Agreement if its counterparty, its counterparty's Credit Support Provider or Specified Entity, if any, undergoes a Designated Event and the creditworthiness of the surviving entity is materially weaker immediately after the Designated Event compared to such party's creditworthiness immediately before the event.</p> <p>“Designated Events” include consolidation, amalgamation, acquisition or change of structure by an entity.</p>	<p>Credit Event Upon Merger is typically applicable to both parties. One way that parties modify this provision is that they may provide for a definition of “materially weaker” with respect to the surviving entity, which for example, can be based on the surviving entity's credit ratings.</p>
<p>Automatic Early Termination, Part 1(e)</p> <p>The parties will elect whether the “Automatic Early Termination” provision will or will not apply to each party.</p> <p>A number of jurisdictions, like the United States, have bankruptcy legislation that exempt OTC derivative contracts from the automatic stay provisions, ipso facto rules, avoidance powers and the trustee or debtor-in-possession's discretion, within prescribed limits, to reject or assume the party's prepetition contracts. As a result, the non-defaulting party is entitled to close-out and net the portfolio of transactions. These exemptions and protections are often referred to collectively as the “safe harbor provisions”.</p> <p>If elected, Automatic Early Termination provides that the termination will have taken place immediately prior to the bankruptcy occurring.</p>	<p>It is not necessary to elect Automatic Early Termination if a party is subject to a bankruptcy regime that has safe harbor provisions.</p> <p>If the parties elect to apply Automatic Early Termination, the non-defaulting party may seek indemnification from the defaulting party for losses attributable to movements in interest or currency rates or market values between the date the Master Agreement is automatically terminated and the day on which the non-defaulting party first became aware that a bankruptcy event had occurred.</p>
<p>Termination Currency, Part 1(f)</p> <p>“Termination Currency” will have the meaning specified in Section 14 of this Agreement unless the parties provide otherwise.</p> <p>Section 14 provides that the default is Euro if the Master Agreement is governed by English law and USD if the Master Agreement is governed by New York law.</p>	<p>The default in the Master Agreement is typically acceptable to most parties.</p>

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<p>Additional Termination Event(s), Part 1(g)</p> <p>Parties will elect whether Additional Termination Event(s) (ATE) will or will not apply to each party.</p> <p>Additional Termination Events are meant to capture credit issues that a party may be having and allow its counterparty to take action whether or not the party is subject to an Event of Default under the Master Agreement. The ATEs are negotiated between the parties and tailored to an entity's risk profile.</p>	<p>If parties elect to apply ATEs, these are some of the ATEs typically negotiated.</p> <ul style="list-style-type: none"> • Credit ratings downgrade events • Decline in equity/net assets • Change in control • Death or resignation of key persons • Material adverse change
<p>Tax Representation, Part 2</p> <p>Payer takes the risk of withholding with respect to any tax other than stamp tax and any tax imposed due to a connection between the Payee and the taxing authority's jurisdiction (an "Indemnifiable Tax").</p> <p>Payer is required to gross up for any withholding arising under an Indemnifiable Tax. In order to avoid having to gross up, both parties provide representations as Payer and Payee.</p>	<p>Parties should consult their tax advisers to determine required tax representations.</p>
<p>Payer Tax Representations, Part 2(a)</p> <p>The standard representation provides that the Payer is not required by any applicable law to make any deduction or withholding for or on account of any tax from any payment (other than with respect to interest) to be made by it under the Master Agreement.</p> <p>In making the representation, the Payer will rely on, amongst other things, representations made by the other party, and tax documentation provided by the other party.</p>	<p>The standard Payer Tax representation in the 2002 Schedule is not amended.</p>
<p>Payee Tax Representations, Part 2(b)</p> <p>Each party makes representations as to its whether or not it will be subject to Indemnifiable Taxes.</p>	<p>The parties will review one another's representations to ensure that, when acting as Payer, that party will not incur any tax liability.</p>
<p>Agreement to Deliver Documents, Part 3(a)</p> <p>The parties will determine what tax forms, documents or certificates are to be delivered.</p> <p>The Payer relies on the tax documentation provided by the Payee to make the Payer representation that the Payer is not required to make any deduction or withholding for or on account of any tax from any payment to be made by it under the Master Agreement.</p>	<p>Each party will deliver a properly executed United States Internal Revenue Service Form W-9 or Form W-8BEN and/or W-8 IMY, as applicable (or successor thereto).</p>

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<p>Agreement to Deliver Documents, Part 3(b)</p> <p>The parties will determine what other documents are to be delivered.</p> <p>Parties are required to deliver certain documents periodically to establish their creditworthiness and authority to trade.</p>	<p>Common documents to deliver include:</p> <ul style="list-style-type: none"> • Constituent documents • Incumbency certificates • Credit Support Document • Power of Attorney/investment management agreement • Financial information <p>Common negotiation points:</p> <ul style="list-style-type: none"> • Timing/frequency of delivery • Description/nature of deliverable • “Catch-all” delivery requirement should be carefully considered. Parties will want to avoid having to scramble to find the requested information.
<p>Address for Notices, Part 4(a)</p> <p>The parties will provide notice information. All notices provided under the Master Agreement will be provided to the entities and at the addresses provided.</p>	<p>Some parties may want to specify different notice information for the delivery of notices of an event of default or termination event.</p>
<p>Process Agent, Part 4(b)</p> <p>Parties may specify a process agent to receive service of process in any proceedings under the Master Agreement.</p>	<p>A party will typically require a process agent if its counterparty is acting through an agent or is located outside of the jurisdiction of the Master Agreement.</p>
<p>Offices, Part 4(c)</p> <p>Parties will elect whether the provisions of Section 10(a) “Offices” are applicable.</p> <p>If Section 10(a) is elected in the Schedule, the parties agree and represent that Transactions entered into with their branches are equivalent to transactions entered into with the home office.</p> <p>If a party is specified as a Multibranch Party in the Schedule, such party is allowed to make payments or deliveries and to book transactions through any office listed in the Schedule.</p>	<p>This provision is typically always applicable.</p>
<p>Multibranch Party, Part 4(d)</p> <p>If a party can transact through multiple branches it will specify that it is a Multibranch Party and the offices through which it will transact.</p>	<p>A Multibranch Party will list the offices through which it will transact.</p>

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<p>Calculation Agent, Part 4(e)</p> <p>The “Calculation Agent” is <i>not</i> defined in the Master Agreement but is defined in the various product-specific ISDA definitional booklets.</p> <p>Typical duties of the Calculation Agent are to:</p> <ul style="list-style-type: none"> • Determine floating rates or prices • Calculate payments to be made • Determine whether an adjustment event has occurred like for example a market disruption event 	<p>The Calculation Agent is typically the dealer. The buy-side will want to include a provision that if the dealer is subject to an Event of Default, the buy-side entity or another leading dealer will serve as Calculation Agent.</p> <p>Parties may also negotiate a dispute resolution mechanism. In the event of a dispute, a substitute calculation agent typically will make the calculation or determination.</p> <p>While parties agree that dispute resolution mechanisms are rarely, if ever, invoked, this is a heavily negotiated provision.</p>
<p>Credit Support Document, Part 4(f)</p> <p>The parties will specify the details of any Credit Support Document.</p> <p>A Credit Support Document is a document which provides credit support for a party's obligation under the Master Agreement. The Credit Support Document can be entered into by third party -like a guaranty, or by a party to the Master Agreement - like a Credit Support Annex.</p>	<p>The parties will add any Credit Support Documents that are subject to the Master Agreement including any Credit Support Annex.</p>
<p>Credit Support Provider, Part 4(g)</p> <p>A party may have a Credit Support Provider- an entity that provides credit support to such party under the Master Agreement- typically in the form of a guarantee.</p> <p>A Credit Support Provider must be an entity that is eligible to enter into over-the-counter derivatives in a accordance with CFTC rules, an “Eligible Contract Participant”.</p>	<p>Each party will specify whether it will have a Credit Support Provider.</p> <p>A party may insist that its counterparty provide a Credit Support Provider if the counterparty does not have an acceptable credit profile.</p>
<p>Governing Law, Part 4(h)</p> <p>Parties may choose the law governing the Master Agreement and the jurisdiction to which disputes arising from the Master Agreement will be submitted. The Agreement offers a choice between English Law and the laws of the State of New York. However, parties are free to subject their Master Agreement to the governing law and jurisdiction of their choice.</p>	<p>The parties will negotiate governing law. Among North American market participants, New York law is the typical choice.</p> <p>Within North America, this provision is generally not subject to negotiation unless both parties are in the same jurisdiction and want to apply that governing law.</p>
<p>Netting of Payments, Part 4(i)</p> <p>The parties will elect whether Multiple Transaction Netting will apply. If Multiple Transaction Netting applies, payments under two (or more) transactions which are due on the same date in the same currency will be netted and only the party owing the greater amount will be required to make the payment of the net amount.</p>	<p>Whether or not Multiple Transaction Netting is elected will depend on the parties’ operational capabilities. Some counterparties are not able to net across various products. In such a case, the election can be made on a product by product basis, e.g., netting applies across commodities transactions.</p>

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<p>Affiliate, Part 4(j)</p> <p>Affiliates is as defined under Section 14 of the Master Agreement, unless the parties provide otherwise in the Schedule.</p> <p>Affiliate as defined in the Master Agreement includes any entity that (<i>directly or indirectly</i>):</p> <ul style="list-style-type: none"> (i) is controlled by a party; (ii) controls a party; or (iii) is under common control with a party. <p>The term Affiliate is used in the Master Agreement in the transfer provision with respect to a Tax Event, as well as when a party is determining a termination payment it may get quotations from its Affiliates.</p> <p>A Tax Event occurs due to:</p> <ul style="list-style-type: none"> • Any action taken by a taxing authority, or brought in a court after a Transaction is entered into, or • A change in tax law, <p>that has the effect that a party will, or there is a substantial likelihood that it will, on the next succeeding scheduled settlement date:</p> <ul style="list-style-type: none"> • be required to pay to the other party an additional amount in respect of an Indemnifiable Tax • receive a payment from which an amount is required to be deducted or withheld for on account of a Tax and no additional amount is required to be paid in respect of such Tax. <p>If a Tax Event has occurred, the affected party will be required to try to transfer affected transactions to an Affiliate and if that is not successful the counterparty can attempt to transfer the affected transactions to its Affiliates.</p>	<p>A party has a few choices for the definition of Affiliates. It can state that:</p> <ul style="list-style-type: none"> • Affiliates as defined under Section 14 will apply to it • Specify only certain entities that will be Affiliates; or • it has no Affiliates.
<p>Absence of Litigation, Part 4(k)</p> <p>For the purpose of the Absence of Litigation representation, each party will specify whether they have a "Specified Entity".</p> <p>The Absence of Litigation covers actual and known threatened litigation against a party, its Credit Support Provider or any named Specified Entity that is likely to affect:</p> <ul style="list-style-type: none"> • The legal enforceability of the Master Agreement or any Credit Support Document, or • that party's performance under the Master Agreement or Credit Support Document. 	<p>Parties can agree to different Specified Entities from Part 1(a). Parties may identify Specified Entities as:</p> <ul style="list-style-type: none"> • All Affiliates; • A Specific list of Affiliates; or • Not Applicable. <p>A party must consider whether it is appropriate for their counterparty to exclude some of their Affiliates given how narrow the representation is.</p>

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<p>No Agency, Part 4(l)</p> <p>The parties will elect whether the Agency provision will apply.</p> <p>The Agency provision states that each party represents that it is entering into the Master Agreement as principal and not as agent.</p>	<p>A party needs to know who it is facing as principal and therefore the Agency provision is typically applicable.</p>
<p>Additional Representations, Part 4(m)</p> <p>The Schedule provides for the following representations in addition to those in the Master Agreement:</p> <ul style="list-style-type: none"> • <u>Non-Reliance</u> - Neither party is relying on the communication of the other party in order to enter into the transactions. • <u>Assessment and Understanding</u> - Each party is capable of assessing the merits of and understands the risk of each transaction. • <u>Status of Parties</u> - Neither party is acting a fiduciary to the other. <p>Parties can add additional representations in this section.</p>	<p>These representations are accepted by the industry. The parties may add additional representations, such as:</p> <ul style="list-style-type: none"> • a party's ERISA status, or • the investment manager's power and authority to act on behalf of the counterparty under the Master Agreement. <p>Whether additional representations will be added will depend on the status of the parties.</p>
<p>Recording of Conversations, Part 4(n)</p> <p>Each party:</p> <ul style="list-style-type: none"> • Consents to the recording of telephone conversations between the trading, marketing and other relevant personnel in connection with the Master Agreement and the transactions thereunder; • Agrees to obtain any necessary consent and give necessary notice of such recordings; • Agrees that recordings may be submitted in an proceeding if permitted by law. 	<p>This provision is typically accepted by both parties.</p>
<p>Other Provisions, Part 5</p> <p>Parties may add additional provisions to the Master Agreement based on their negotiations, their jurisdiction of incorporation and the regulatory regime that governs the Master Agreement. Those additional provisions will typically be included in Part 5 of the Schedule.</p>	

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<p>2002 Master Agreement Protocol</p> <ul style="list-style-type: none"> • Prior to publication of the 2002 ISDA Master Agreement, ISDA published a number of definitional booklets and credit support documents that reference terminology and provisions in the 1992 ISDA Master Agreement (“Legacy Documents”). • If the 2002 Master Agreement is being used, it is necessary to replace the references to terms of the 1992 Master Agreement in these Legacy Documents with references to terms of the 2002 Master Agreement. <p>By adopting the Protocol, the parties agree to amend these various documents to reflect the new terminology and provisions set forth in the 2002 ISDA Master Agreement.</p>	<p>The parties will incorporate by reference the 2002 Master Agreement Protocol.</p>
<p>Waiver of Jury Trial</p> <p>Parties typically add language in which they agree to waive any right it may have to a trial by jury in respect of any proceedings relating to the Master Agreement or any Credit Support Document.</p>	<p>Most parties typically agree to waive jury trial. However, some market participants, such as governmental plans, have policies in place prohibiting waiver of jury trial.</p>
<p>Condition Precedent, Section 2(a)(iii) of the Master Agreement</p> <p>Section 2(a)(iii) of the Master Agreement provides that a party's payment and delivery obligations are suspended if any of the following occurs:</p> <ul style="list-style-type: none"> • Event of Default with respect to the other party • “Potential Event of Default” with respect to the other party, <i>defined as</i>: an event that, with the giving of notice or the passage of time, would constitute an Event of Default • the occurrence or designation of a date to terminate the transactions under the Master Agreement (an “Early Termination Date”) with respect to the transaction in question. 	<p>Parties often seek modification of Section 2(a)(iii) based on a concern that the non-defaulting party could suspend payments/performance under the Master Agreement indefinitely (subject to applicable law).</p> <p>The parties will negotiate a limitation on the condition precedent, requiring the non-defaulting party to terminate the trades under the Master Agreement within a certain period of time or to resume payments and deliveries.</p>
<p>Confidentiality Provision</p> <p>Counterparties, especially those with proprietary trading strategies and operations, may want to include confidentiality provisions to protect their financial information and trade data.</p> <p>Some provisions require barriers so that information regarding a party's trading is not shared with the other party's proprietary trading operations.</p>	<p>Most dealers are reluctant to add a confidentiality provision in the Master Agreement and prefer a separate non-disclosure agreement as the specific confidentiality requirements are easier to track if they are not embedded in the Master Agreement</p>