December 2011

Repo and the Eurozone Crisis

1. INTRODUCTION

1.1 The ongoing eurozone crisis, and in particular the scenario where one or more eurozone members exit the single currency, presents many questions in relation to financial transactions. In repo transactions, the existence of a cash and securities leg combined with the various structural features of repo gives rise to a number of pertinent issues unique to repo. This briefing considers some of the key issues in relation to repo in the context of the hypothetical departure of a single eurozone member state from the single currency.

2. BACKGROUND

2.1 The exit of a eurozone member from the single currency could arise in a number of different ways. There is currently no mechanism in the EU treaty framework for any member state to leave the euro, without also leaving the EU. Consequently any exiting state (**"Exiting State"**) would either need to leave the EU or negotiate an exit from the euro. It is also theoretically possible that an Exiting State would do so unilaterally in breach of its existing treaty obligations.

2.2 It is, of course, also conceivable that there may be more than one Exiting State or that the euro may split into two or more currency blocs or that the entire eurozone devolves into 17 new currencies.

2.3 Each of the above scenarios would give rise to a different set of legal considerations and involve a considerable number of unknowns. For example, it is possible that there would be new EU legislation and/or EU treaty amendments and/or new domestic legislation in the Exiting State or in other member states. The Exiting State may also introduce exchange, capital and/or asset controls. There may also be industry protocols. Finally, any redenomination of debts by the Exiting State could apply to any combination of sovereign debt, debt of any entities incorporated or resident in the Exiting State, debts subject to the governing law of the Exiting State, debts to be enforced in the Exiting State or any debt payable in the Exiting State.

2.4 Given the numerous permutations of a eurozone exit, and in order to simplify the analysis and consideration of the issues, this briefing proceeds on the basis of the following scenario and assumptions:

(a) a single Exiting State leaves the eurozone and introduces national legislation establishing a new domestic currency and redenominating all sovereign debt and the debt of any entity incorporated in the Exiting State;

(b) a hypothetical repo transaction has been entered into between a Buyer and Seller under a standard unamended 1995 or 2000 Global Master Repurchase Agreement (**"GMRA"**) where the Buyer has paid the Seller a purchase price denominated in euro against a transfer of purchased securities in the form of euro-denominated government bonds (**"EGB"**) issued by the Exiting State. The Seller is incorporated in the Exiting State. The Buyer is incorporated in England;

(c) no insolvency has occurred in respect of either the Buyer or the Seller (or any other relevant entity);

(d) any EU legislation or treaty amendments passed to facilitate the exit do not address or affect the issues discussed below; and

(e) no repo industry protocol is developed to attend to the exit.

2.5 Finally, the matters under discussion here may come before courts other than English courts. Although the parties submit to the jurisdiction of the English courts in paragraph 17 of the GMRA 1995/2000, that clause is a non-exclusive jurisdiction clause so that the parties are free to sue in other competent courts. The Seller may seek to bring an action in the Exiting State. In addition, it may become necessary to enforce an English judgment in the courts of the Exiting State. Other courts may reach judgments based upon different principles to those discussed in this briefing. In particular, a court of the Exiting State may be more likely to reach a position which is consistent with any domestic legislation passed in the Exiting State, regardless of the position under English law.

2.6 Unless the context otherwise requires, capitalised terms not defined herein are as defined in the GMRA 1995 and/or GMRA 2000 as applicable.

3. KEY ISSUES IN THE CONTEXT OF REPO

3.1 Where a member state exits the eurozone in the scenario posed by this briefing, the key issues in the context of a repo are the following:

(a) **Repurchase Price** - is the currency of the Repurchase Price (euro in our example) affected by the departure of the Exiting State and the creation of the new domestic currency? Specifically, would the Seller still be obliged to pay the Buyer in euro or can the Seller repay in the new domestic currency?

(b) **Equivalent Securities/Equivalent Margin Securities and redenomination** – if the Purchased Securities or Margin Securities are redenominated from euro into the new domestic currency, what is the transferee permitted/obliged to redeliver as Equivalent Securities/Equivalent Margin Securities?

(c) **Income payments** – if the Buyer (or transferee in the case of Margin Securities) receives Income in the new domestic currency of the Exiting State, what currency is it obliged to pay across to the transferor under the provisions of paragraph 5 of the GMRA 1995/2000?

(d) **Margin maintenance** – what would be the effect (if any) on the margining provisions of paragraph 4 of the GMRA 1995/2000?

(e) **Events of Default** – would an Event of Default under paragraph 10(a) of the GMRA 1995/2000 be triggered by the departure of the Exiting State, the introduction of the new domestic currency or the introduction of exchange/capital/asset controls?

(f) **Close-out netting provisions** - what would be the effect (if any) on the close-out netting provisions of paragraph 10 of the GMRA 1995/2000?

(g) **Tax event** – would the departure of the Exiting State, the introduction of the new domestic currency or the introduction of exchange/capital/asset controls give rise to an event enabling paragraph 11 of the GMRA 1995/2000 to be triggered?

(h) **Frustration** - would the departure of the Exiting State, the introduction of the new domestic currency or the introduction of exchange/capital/asset controls terminate or discharge obligations under the transaction by reason of frustration?

3.2 There may, of course, be many other questions which arise dependent on the circumstances and we would be happy to consider these in a subsequent briefing.

4. REPURCHASE PRICE

4.1 If the Purchase Price of a repo is denominated in euro and the currency of the jurisdiction of the Seller changes to a new domestic currency, together with a redenomination of the currency of the underlying Purchased Securities into the new domestic currency, then the question naturally arises whether the Seller is obliged to repay in euro or in the new domestic currency. From the Buyer's perspective, assuming that the new currency is weaker than the euro, it will presumably wish to ensure that it is repaid in euro. This will be the case particularly if the transaction was a funding or cash-driven transaction.

4.2 The starting point is to construe the contract in accordance with English law as its governing law.

4.3 The GMRA requires all payments made in respect of the Purchase Price or Repurchase Price to be made in the Contractual Currency and defines "Contractual Currency" as the currency of the Purchase Price of a transaction (paragraph 2(h) GMRA 1995/2(i) GMRA 2000 and paragraph 7(a) GMRA 1995/2000). The pro forma Confirmation includes a line item for parties to specify the Contractual Currency in order to add certainty.

4.4 In the scenario posed by this briefing, the Purchase Price is denominated in euro and therefore the Contractual Currency is the euro. Consequently, the contract provides for the Repurchase Price to be paid in euro.

4.5 However, given that the Exiting State has left the single currency and established a new domestic currency, the Seller is incorporated in the Exiting State and the Exiting State has purported to redenominate its debts and those of its nationals, this raises the question of the meaning of "euro", at least in the context of the Repurchase Price. In particular, does "euro" mean:

(a) the single currency of the member states participating in the eurozone from time to time; or

(b) the currency of the jurisdiction of the Seller from time to time, which happened to be euro at the time of entering into the transaction; or

(c) the currency of the jurisdiction of the issuer of the underlying Purchased Securities from time to time, which happened to be euro at the time of entering into the transaction?

4.6 In order to determine the meaning of "euro", you would again start by analysing the contract to see how "euro" has been defined. In repo transactions, however, the position is typically somewhat unsatisfactory. There is no definition of euro in the GMRA and no standard definitions are incorporated into Confirmations unlike, for example, the derivatives market where transactions will usually incorporate one of the various ISDA definitions booklets. It is therefore left to the parties to include a definition of any currency terms that they use, including any reference to "euro", "EUR" or "€". This means that the position will depend on a trade by trade analysis of whether a definition of euro has been included at all (as in many cases no definition is added to a Confirmation) and, if so, an analysis of the wording of that definition. We have considered the following scenarios (subject to the discussion in the remainder of this briefing):

(a) If a standard definition has been included along the lines of the standard ISDA definitions (of which there are several including "the lawful currency of the member states of the European Union that adopt the single currency in accordance with the EC Treaty"), then this should result in a construction that euro is intended to mean the single currency of the eurozone from time to time and not the new domestic currency.

(b) If a definition has been included (which we assume is very unlikely) defining the euro as the currency from time to time of a particular member state (such as the Exiting State), then this should result in a construction that euro is intended to mean the currency of that member state, which will be the new domestic currency in the case of the Exiting State.

(c) If a different definition has been included, its meaning and effect will need to be considered on a case by case basis.

(d) If no definition has been included, then there is contractual ambiguity and uncertainty as to which of the possible interpretations prevails, although we believe there to be a good argument that, as the euro still exists, the contract should be construed to refer to the euro in its continuing form.

4.7 However, the express wording of the contract is only the starting point as other legal principles including conflicts of laws rules must also be considered. In that regard, English law distinguishes between the "money of account" and the "money of payment".

4.8 "Money of account" addresses the question "in what currency is the payment obligation (i.e. the Repurchase Price) expressed/measured?". If there is any doubt as to which this currency is, the contract would be interpreted in accordance with applicable law, which in our example would be English law (under the provisions of European Parliament and Council Regulation (EC) 593/2008 (also known as "Rome I")). Under English law, in clarifying any doubt as to currency of account, one relevant consideration is a presumption that the parties intended to refer to the currency of the jurisdiction with which the contract is most closely connected. Relevant factors in our scenario would include that the Exiting State is the jurisdiction of both the Purchased Securities and of the Seller, which may lead to an argument that the relevant currency is the new domestic currency. There is also a rebuttable (and relatively weak) presumption that, if a place of payment is specified, the parties intended the currency of the money of account to be the same as that of the money of payment.

4.9 "Money of payment" addresses the question "in what currency is the payment obligation (i.e. the Repurchase Price) to be discharged?". Where there is uncertainty, the relevant law may be the law of the country in which the payment is to be made and the debt discharged. Under the GMRA, place of payment is addressed in the transaction Confirmation where, in accordance with paragraph 3(b)(v) of the GMRA 1995/2000, each party specifies the details of a bank account to which payments under that transaction are to be credited. Consequently, in the case of the Repurchase Price, this will be wherever the Buyer's specified account for euro payments is located. Different parties in the market may have their euro accounts located in different eurozone countries – this may lead to market uncertainty as there may be a variety of different applicable laws being used to determine the currency in which a euro-denominated Repurchase Price is to be discharged (and potentially, as a consequence, which could become the currency of the money of account too).

4.10 Against all of this it could be argued (quite strongly in our view) that, in the case where the parties have not included any express definition of euro in the GMRA, there is no uncertainty, as the currency is specified in the contract to be "euro" and that is clearly understood to be the single currency of the eurozone, which continues to exist. This is not a case where, for example, the currency is expressed in a form which is common to several different currencies (such as "Dollars" but without specifying whether that is, say, US or Canadian or Australian Dollars) or a scenario where the specified currency has ceased to exist.

4.11 The "*lex monetae*" principle is the principle that the law of a sovereign state determines what constitutes its currency and what is legal tender in that state. For example, if an obligation refers to pounds sterling, it would be for English law to determine what that currency is and what is legal tender in England. Furthermore, a sovereign state is free to regulate its currency through, for example, substitution of a new unit and the establishment of the relevant conversion rate to that unit. In the context of a euro obligation, the lex monetae is likely to be the body of European treaty law constituting the euro and may therefore be relevant to the analysis, particularly if there are changes to the treaties as a result of the Exiting State leaving the eurozone.

4.12 Finally, if the Exiting State imposes exchange controls making it illegal to pay the Repurchase Price in euro, then this could have the effect that an English court would not order payment in euro. See section 8 below for a discussion of a potential Event of Default in these circumstances.

4.13 In conclusion, the approach in the relevant contracts to the definition of "euro" will be key to the level of certainty that a Repurchase Price obligation denominated in euro will be repayable in euro notwithstanding the introduction of the new domestic currency and the redenomination of any debt. If the definition is clear, then unless the place of payment is in the Exiting State or exchange controls are imposed, there should be limited risk. Where there is ambiguity in the definition, or no definition at all, then there will be uncertainty as to the legal position, although a likelihood in our view that "euro" would be interpreted as the single currency of the eurozone in its continuing form if the currency still exists.

4.14 It is also worth noting that, since the question of whether or not any securities which are the subject of the repo may be validly redenominated into the new domestic currency is an entirely separate question from whether the Repurchase Price remains payable in euro, it is possible that the effect of the redenomination may be to turn the repo from a single currency repo into a cross-currency one if the Repurchase Price remains denominated in euro but the Purchased Securities become denominated in the new domestic currency.

5. EQUIVALENT SECURITIES/EQUIVALENT MARGIN SECURITIES AND REDENOMINATION

5.1 In the scenario posed by this briefing the Exiting State has passed legislation redenominating all debts owed by it or by its nationals from euro into the new domestic currency.

5.2 This would affect the Purchased Securities in our scenario and any Margin Securities issued by the Exiting State or entities incorporated in the Exiting State.

5.3 Whether that redenomination would be effective has been the subject of considerable market analysis already and depends on a variety of factors including the terms and conditions of the relevant securities, the governing law of the relevant securities, the jurisdiction clause under the relevant securities, the jurisdiction of any court seized of the matter, and the place of payment of the relevant securities.

5.4 For the purposes of this briefing, we will assume that any such redenomination is effective. In these circumstances, what is the position of the Buyer (in respect of Purchased Securities) or transferee (in respect of Margin Securities)?

5.5 The Buyer is required to return "Equivalent Securities" at the maturity of the repo and the transferee of Margin Securities is required to return "Equivalent Margin Securities" when margin is recalled. "Equivalent Securities" and "Equivalent Margin Securities" are both defined by reference to securities which are "equivalent to" the securities originally transferred as Purchased Securities/Margin Securities. The phrase "equivalent to" is itself then defined (paragraph 2(p) GMRA 1995 / paragraph 2(t) GMRA 2000). The GMRA 1995 and 2000 definitions are different, with the GMRA 2000 definition being more extensive.

5.6 In the GMRA 1995 definition, "equivalent to" means securities which are "(i) of the same issuer; (ii) part of the same issue; and (iii) of an identical type, nominal value, description and (except where otherwise stated) amount as" the original securities.

5.7 The GMRA 2000 definition of "equivalent to" is the same but goes on to include the following further specific examples of events which do not destroy the equivalence and which clarify what would be considered to be "equivalent" securities:

(a) "equivalent to" is defined to include securities redenominated <u>into</u> euro or whose nominal value has changed in connection with such a redenomination (paragraph 2(t)(A) GMRA 2000); and

(b) in the situation where the holders of securities have become entitled to receive or acquire other Securities or property, "equivalent to" means securities equivalent to the original securities together with or replaced by a sum of money or securities or other property equivalent to that receivable by holders of the original securities (paragraph 2(t)(B) GMRA 2000).

5.8 Consequently, neither the GMRA 1995 nor the GMRA 2000 expressly contemplates the redenomination of securities from euro into a domestic currency. The GMRA 2000 comes closest with the reverse scenario of a redenomination into euro, and a potentially wider scenario in paragraph 2(t)(B) of holders becoming entitled to receive other property and including within the definition of what is equivalent "a sum of money…equivalent to that receivable by holders…".

5.9 If the redenomination affects all (and not part only) of the relevant issue of securities, it is likely that, under both the GMRA 1995 and the GMRA 2000, these would be "equivalent to" the original securities for the purposes of the GMRA and therefore the Buyer/transferee is both permitted and required to redeliver the redenominated securities. The argument is stronger with the GMRA 2000 than with the more limited wording of the GMRA 1995, but in each case this is consistent with the structure, economics and purpose of repo under which the original transferor remains economically exposed to the securities and should be kept in the same position, to the extent possible, as if it had continued to own the securities throughout the repo. If the redenominated securities were found not to be "equivalent", this would have the effect that no securities could be equivalent to the original securities for the purposes of the repo, and therefore it would become impossible for the Buyer/transferee to transfer "equivalent" securities. Each party would be at risk of an Event of Default for failure to deliver "Equivalent Securities"/"Equivalent Margin Securities" and we believe that to be a very unlikely interpretation of the contract.

6. INCOME PAYMENTS

6.1 Paragraph 5 of the GMRA 1995/2000 requires the Buyer (of Purchased Securities) or transferee (of Margin Securities) to pay to the Seller/transferor an amount equal to any Income payments, such as coupons and dividends, paid by the relevant issuer. These provisions reflect the intended economic nature of the standard repo relationship such that market risk and reward remains with the original owner of the securities notwithstanding the outright transfer of those assets to the other party.

6.2 Two relevant points arise from our scenario in relation to paragraph 5:

(a) First, it is made expressly clear that the payment to be made by the Buyer/transferee must be made "in the same currency as" the Income paid by the issuer. Therefore, currency risk remains with the original owner of the securities. In the scenario considered in this briefing, the euro still exists but the Exiting State has introduced a new domestic currency. Whether the EGBs (or any Margin Securities) can be validly redenominated into the new domestic currency is discussed in section 5 above. However, due to the wording of paragraph 5 of the GMRA 1995/2000, whether or not the securities are redenominated, and whatever currency the Income is paid in, the Buyer/transferee pays an amount in that currency. Thus, the original Seller/transferor bears the currency risk of any redenomination.

(b) Second, the Buyer/transferee is only obliged to pay to the Seller/transferor "an amount equal to" the amount paid by the issuer. Therefore, notwithstanding any redenominated currency being effectively devalued and becoming worth less than the euro equivalent, and whatever exchange rate is officially used by the Exiting State to determine the amount of new domestic currency to be converted from the original euro amount, the original Seller/transferor bears the risk of this devaluation or exchange rate calculation.

7. MARGIN MAINTENANCE

7.1 One of the key concepts in repo is margin maintenance, being the ability of the parties to collateralise their exposure to one another. The margining provisions of paragraph 4 of the GMRA 1995/2000 essentially measure exposure as the difference between the Repurchase Price on the one hand and the value of the Purchased Securities on the other (this is simplified for the purposes of the analysis). Redenomination of one or other of those sides of the repo into the new domestic currency may have the effect of significantly revaluing (downwards or upwards depending on whether the Exiting State is a stronger or weaker member of the eurozone) that leg, which in turn may have a significant effect on the exposure of one party to the other and may result in a trigger of significant margin calls to address that exposure. Any affected counterparty may face liquidity issues as a result, especially if it has large aggregate repo positions across the market.

7.2 In calculating exposure for margining purposes, the value of any securities whose market price is quoted in a currency other than the Contractual Currency must be converted into the Contractual Currency at the Spot Rate prevailing at the relevant time. On the assumption that the EGBs are redenominated into the new domestic currency, and assuming that the Contractual Currency is euro, the value of the EGBs would need to be converted into euro at the Spot Rate creating the shift in exposure discussed above.

7.3 The margining provisions use the concepts of both Contractual Currency and Base Currency in the calculations of exposure. In these applications of those concepts, they are merely tools for making a calculation rather than themselves being the currency of a payment obligation. Consequently, to the extent that they are defined to be "euro", the analysis of the meaning of "euro" should be primarily one of contractual construction in accordance with the governing law.

7.4 Payments of cash margin denominated in euro by the Seller to the Buyer would, on the other hand, be subject to an equivalent analysis to that applicable to payments of Repurchase Price as discussed in section 4 above.

8. EVENTS OF DEFAULT

8.1 Paragraph 10(a) of the GMRA 1995/2000 sets out those events that constitute Events of Default (**"EOD"**). Whilst we think it unlikely that any of the EODs could be relied upon as a direct result of the scenario contemplated in this briefing, the following EODs are worthy of discussion.

8.2 Paragraph 10(a)(i) states that an EOD occurs where the Seller fails to pay the Repurchase Price on the Repurchase Date. If the Repurchase Price (as discussed at section 4 above) is found to remain denominated in euro despite the implementation by the Exiting State of a new domestic currency, then if the Exiting State has implemented exchange controls preventing the Seller from paying the Repurchase Price in euro, it is possible that an EOD will occur if the Seller is not able to pay the Repurchase Price on the Repurchase Date. However, as discussed in section 4 above, the imposition of exchange controls by the Exiting State may relieve the Buyer from the obligation to pay the Repurchase Price in euro if it would be illegal to do so. In such a case it is unclear whether an EOD would be triggered. The same analysis will apply in respect of any other EODs triggered by failures to pay cash denominated in euro (such as a failure to pay cash margin or income denominated in euro under paragraphs 10 (a)(ii) and (iii) GMRA 1995 and 10(a)(iii), (iv) and (v) GMRA 2000).

8.3 Paragraph 10(a)(ii) of the GMRA 2000 provides for an EOD (if elected to apply in Annex I) for failure by the Buyer to deliver Equivalent Securities on the Repurchase Date. Whether redenominated securities constitute Equivalent Securities for this purpose is discussed under section 5 above.

8.4 Paragraph 10(a)(iv) GMRA 1995/paragraph 10(a)(vi) GMRA 2000 provides for an EOD upon an Act of Insolvency of either party. This would not be triggered directly by the scenario contemplated in this briefing but remains relevant given the possible effect of a withdrawal from the euro (through a potential devaluation of the new domestic currency, increased margin calls etc.) on a counterparty incorporated in the Exiting State.

8.5 Paragraph 10(a)(v) GMRA 1995/paragraph 10(a)(vii) GMRA 2000 provides for an EOD upon a breach of representation. Paragraph 9(e) of the GMRA 1995/2000 contains a representation that "...performance of this Agreement and the Transactions contemplated hereunder will not violate any law...or rule applicable to it...". This representation is deemed to be repeated when a Transaction is entered into and on each date when Securities, Equivalent Securities, Margin Securities or Equivalent Margin Securities are to be transferred under any Transaction. It is conceivable that the imposition of exchange controls could lead to a breach of this representation, particularly given that the GMRA does not contain a force majeure or illegality provision.

8.6 Paragraph 10(a)(vi) GMRA 1995/paragraph 10(a)(viii) GMRA 2000 provides for an EOD upon a party admitting that it is unable to perform any of its obligations. Again, it is conceivable that the imposition of exchange controls could lead to a breach of this representation. The affected party may in turn argue that it is not unable to perform its obligations but has been prevented from doing so by a change in law.

9. CLOSE-OUT NETTING PROVISIONS

9.1 The close out netting provisions are contained principally in paragraphs 10(b) and (c) GMRA 1995 and 10(b) to (e) GMRA 2000. For present purposes, two elements require discussion, but it should be noted that we do not consider here the position where a party has become insolvent as that will raise insolvency law issues which will be relevant to the analysis below.

Valuation

9.2 Paragraph 10(c)(i) of the GMRA 1995/2000 provides for the establishment by the non-defaulting party of the Default Market Values of the Equivalent Securities and any Equivalent Margin Securities to be transferred, the amount of any Cash Margin to be transferred and the Repurchase Prices to be paid by each party.

9.3 We have already discussed the analysis to be applied when determining the currencies of Cash Margin and Repurchase Price and those same principles will be applicable here notwithstanding that the Repurchase Price and the repayment of Cash Margin have been accelerated.

9.4 We have also discussed Equivalent Securities and Equivalent Margin Securities at section 5 above and concluded that the redenominated securities are likely to constitute Equivalent Securities. On that basis, the Default Market Values of Equivalent Securities and Equivalent Margin Securities would be determined in the new domestic currency of the Exiting State. This is consistent with the valuation methodology in the GMRA, which relies on sale proceeds, market quotations or fair market value as determinants of the Default Market Value, all of which would have to be measured in the new currency following a redenomination.

Calculation and payment of net balance

9.5 On the basis of the sums established at the valuation stage, paragraph 10(c)(ii) of the GMRA 1995/2000 requires that all obligations are set off leaving a single net sum payable by the party owing the larger amount. For the purposes of this calculation all sums not denominated in the Base Currency must be converted into the Base Currency on the relevant date at the Spot Rate prevailing at the relevant time.

9.6 If the Base Currency specified for this purpose is euro, the same question arises as to the meaning of "euro" for this purpose. In this context, the Base Currency is used both as a unit of calculation for the purposes of the conversions and also as a unit of payment for the purposes of payment of the net balance. Therefore, the analysis of the meaning of "euro" is likely to follow the same approach as is applicable to payment obligations discussed in relation to the Repurchase Price in section 4 above.

10. **TAX EVENT**

10.1 Paragraph 11 of the GMRA 1995/2000 is a termination event entitled "Tax Event" but has been drafted widely so that it may encompass other changes that have a material adverse effect on a party to a transaction. In other words, it can be read in effect as a form of material adverse change clause.

10.2 The effect of the clause is that either party materially adversely affected by a tax event may terminate any affected Transaction upon notice (paragraph 11(a) and (c) GMRA 1995/2000) subject to a right of veto (upon providing an indemnity) by the other party.

10.3 However, the wording of the clause extends to "any change in the fiscal or regulatory regime (including, but not limited to, a change in law…)" that "has or will, in the notifying party's reasonable opinion, have a material adverse effect on that party in the context of a Transaction". In theory, this is wide enough to capture, for example, the Exiting State introducing new laws imposing exchange or capital controls or potentially even the introduction of the new domestic currency itself. Against this it could be argued that the clause is intended to cover tax and tax-related issues only and therefore the wording should be given a narrow construction. However, the literal wording is clearly wider than required to just cover tax and so the possibility of its application by a counterparty based in the Exiting State cannot be ruled out.

11. **FRUSTRATION**

11.1 In our view, in the scenario posed by this briefing it is unlikely that a repo agreement would be frustrated by the departure of a single Exiting State from the eurozone. The legal criteria for frustration are difficult to satisfy and in this case the key economic obligations relating to the payment of the Repurchase Price and the delivery of Equivalent Securities are capable of being satisfied, as there would be a currency in which the Repurchase Price could be paid (be it euro or the new domestic currency) and the redenominated EGBs would be Equivalent Securities thus allowing delivery of Equivalent Securities at maturity.

12. **CONCLUSION AND POSSIBLE ACTION**

12.1 The above is a summary of some of the potential issues that may arise in the event that the scenario posed by this briefing materialises, and the potential consequences of those issues for repo transactions. As mentioned above it should be noted that even with the assumptions made in relation to the stated scenario it is difficult to predict with any certainty how an exit from the eurozone may occur and what legal framework will evolve to effect it. The circumstances surrounding an exit will have a significant bearing on the analysis and in that regard the conclusions and views expressed above will vary according to the actual facts. The uncertainty over the likelihood and form of a eurozone break-up in turn creates uncertainty over the legal consequences of a break-up.

12.2 What can be done to provide greater certainty in respect of transactions?

12.3 For existing transactions, industry associations should take the lead in establishing market consensus around the key issues, and in respect of lobbying governments to make adequate provision to address any potential uncertainty. It is not clear whether a protocol similar to the one used by some market associations upon a country joining the eurozone would be capable of addressing all of the issues, as a break-up raises some unique issues which are not raised by entry into a single currency. In addition it would not be possible to legislate with a single rule for all of the differing commercial intentions and expectations of the parties in all of their transactions. It is possible that only bilateral agreement between counterparties can adequately provide for how to deal with some of their existing transactions.

12.4 For new transactions or new repo agreements, there are perhaps one or two areas which participants could usefully consider addressing:

(a) Definition of "euro": since one of the main areas of uncertainty is what the parties mean when they refer to "euro" i.e. the single currency, regardless of how many or few members remain in it from time to time, or the currency of the jurisdiction of the issuer of the relevant underlying security or of the counterparty, which just happens to be euro at that time, parties could be more specific in their definition of euro for the purposes of any specific transaction and make it clear that, for example, it remains the single currency regardless of the withdrawal of any particular member state. Clearly this will not assist in the scenario where there is a complete break-up but it is extremely difficult contractually to provide adequately for that eventuality.

(b) Termination rights: parties may wish to consider including specific termination rights to be triggered in the event of a specified member state leaving the eurozone.

(c) Non-exclusive jurisdiction clauses: subject to any other relevant factors, parties may wish to consider whether to include exclusive jurisdiction clauses submitting to the exclusive jurisdiction of the English courts rather than the current non-exclusive jurisdiction clauses.

(d) Place of payment: subject to any other relevant factors, parties may wish to consider specifying a place of payment for their transactions outside any country where there is a significant concern of an exit from the eurozone.

For further information on any aspect of this briefing, please speak to Chris Georgiou, Jonathan Haines or Nicholas McDonald or your usual contact.

Christopher Georgiou
Partner
T: +44 (0)20 7859 2149
E: christopher.georgiou@ashurst.com

Jonathan Haines
Partner
T: +44 (0)20 7859 1396
E: jonathan.haines@ashurst.com

Nicholas McDonald
Solicitor
T: +44 (0)20 7859 2721
E: nicholas.mcdonald@ashurst.com