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Publication of the GMSLA 2009

30 July 2009

Introduction

On 24 July the International Securities Lending Association (“ISLA”) published the July 2009 version of the Global Master Securities Lending Agreement (the “GMSLA”), the long-awaited update to the industry standard master agreement for securities lending transactions, together with the 2009 UK tax addendum. The GMSLA 2009 updates the existing GMSLA 2000, with key changes to the way in which securities are valued post-default and to a party’s remedies following a failure by the other party to re-deliver securities or collateral.

Set-off Protocol

In April this year ISLA published the ISLA 2009 Securities Lending Set-off Protocol (“Protocol”), which enables adhering parties to update the close-out valuation provisions of their existing securities lending master agreements entered into with other adhering parties in order to reflect the close-out valuation provisions in the GMSLA 2009. Parties can therefore update not only their existing GMSLA 2000 but also any existing Overseas Securities Lender’s Agreements (the OSLA), Master Equity & Fixed Interest Stock Lending Agreement (MEFISLA) and Master Gilt Edged Stock Lending Agreement (GESLA). The Protocol does not, however, extend to the other amendments to the GMSLA 2009. Parties can apply the terms of the GMSLA 2009 to existing stock loans entered into under the GMSLA 2000 or any other securities lending agreement by entering into a GMSLA 2009 and specifying in the Schedule the existing master securities lending agreement(s) which are to be replaced by the terms of the GMSLA 2009.

Summary of the main changes

The following is a summary of the main changes to the GMSLA made by the July 2009 version.

1. **Valuation following an Event of Default:** The provisions for calculating the amount payable on a termination of the GMSLA and all loans thereunder have been substantially revised. These have been aligned with the valuation mechanics in the Global Master Repurchase Agreement 2000 (“GMRA”) and use the same terminology as the GMRA.

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In particular:

- **Buy-in price/sale price:** the treatment of a buy-in/sale of securities following termination of the GMSLA has been amended. Under the GMSLA 2000, if the non-defaulting party had bought/sold identical securities to the loaned securities/collateral securities in the five business days following the Event of Default, then that sale/purchase price had to be treated as the value for the purposes of calculating the termination payment. Under the GMSLA 2009 the non-defaulting party has the option to elect to treat such sale/purchase price as the "Default Market Value" but it is not obliged to do so (this is the same as the position as under the GMRA).
- **Default Market Value:** the non-defaulting party has more flexibility as to the valuation of the securities. Under the GMSLA 2000, in the absence of a buy-in/sale price of the securities, the non-defaulting party had to determine the best available bid/offer price on the first or second Business Day following the Event of Default. Under the GMSLA 2009 the Non-Defaulting Party can use quotes from market makers obtained at any time in the five dealing days following the Event of Default **and** if it determines that it would not be commercially reasonable to use such quotes then it can determine the value of the securities itself by reference to such pricing sources as it considers appropriate (this is also the same as the position under the GMRA).
- 2. **Events of Default:** The Events of Default have been amended and in certain cases tightened up to provide for an Event of Default in a narrower set of circumstances than previously:
 - **Automatic Early Termination:** Automatic Early Termination of the GMSLA without notice from the non-defaulting party following certain insolvency events is now an election to be made in the Schedule and is not automatic (as it was under the GMSLA 2000). This aligns the GMSLA with the position under the ISDA Master Agreement, enabling parties to retain control over the termination of the GMSLA following an insolvency of the other party unless it would be prudent to elect for Automatic Early Termination to avoid any 'cherry picking' of transactions by a liquidator of the defaulting party.
 - **Failure to deliver Equivalent Securities or Equivalent Collateral:** This is no longer an Event of Default. The party entitled to receive the Equivalent Securities or Equivalent Collateral has the right to terminate the stock loan in respect of which the Equivalent Securities or Equivalent Collateral were due; this is not a new right but it has been clarified in the GMSLA 2009 that it is this limited termination right which applies and such failure to deliver will not be an Event of Default. In addition, the party entitled to receive the Equivalent Securities or Equivalent Collateral can claim any losses/costs as a result of such failure from the other party,

"The provisions for calculating the amount payable on a termination of the GMSLA and all loans thereunder have been substantially revised. These have been aligned with the valuation mechanics in the GMRA giving the non-defaulting party more flexibility as to the valuation of the securities."

including any costs as a result of a third party under a separate agreement exercising a right of buy-in.

- **Failure to pay the amount due on a 'mini close out':** The GMSLA now clarifies that if a mini close-out occurs and the defaulting party fails to pay the mini close-out amount due then an Event of Default occurs immediately.
- **Failure to deliver Loaned Securities on the due date:** This is no longer an Event of Default.

There are further amendments and clarifications to the other Events of Default, the effect of which is generally to provide more detail on when the particular event will constitute a Event of Default for the purposes of the GMSLA.

3. **Set-off:** The GMSLA 2009 now contains a contractual right of set-off entitling the non-defaulting party to set-off amounts due between the parties arising under other agreements entered into by the parties.
4. **Manufactured Dividends:** The GMSLA 2009 provides greater clarity on the amount of manufactured dividends payable by the Borrower (in respect of Loaned Securities) and the Lender (in respect of Collateral Securities), and the date by reference to which such obligation arises.
 - **Income Record Date:** Manufactured dividends are now payable by reference to the Income Record Date (the date by which holders of securities are identified as being entitled to payment) rather than the Income Payment Date (the date on which income is paid by the Issuer).
 - **Loaned Securities: gross paid amount:** The amount of manufactured dividends payable on Loaned Securities is either the amount agreed between the parties or, in the absence of any agreement, it is the **gross** amount paid by the Issuer without any withholding.
 - **Collateral Securities: net received amount:** In respect of any Collateral Securities, the amount of manufactured dividends payable is either the amount agreed between the parties or, in the absence of any agreement, the **net** amount received by the party holding the collateral, after any withholding tax and without reference to any tax credit to which the Lender may be entitled. However, the party which originally transferred the collateral (the Borrower) has the right to call for re-delivery of Equivalent Collateral Securities prior to the relevant income record date. If Equivalent Collateral Securities are not re-delivered by the Lender then the Borrower is indemnified in respect of any loss which it suffers, which includes any withholding tax that it would not have incurred had it been holding the Collateral Securities on the income payment date. This indemnity can be 'switched-off' in the Schedule to the GMSLA.

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5. **Market Value:** The GMSLA 2009 includes amendments to the way in which securities that have been suspended from trading or cannot be legally transferred (following, for example, a nationalisation or expropriation) are to be valued; in the absence of agreement between the parties on the Market Value there is a fallback to the price based on quotes from four reference market makers. Previously, any such securities which had been delivered as collateral were valued at zero.
6. **Taxes:**
 - **Withholding tax:** The GMSLA 2009 contains new provisions clarifying that payments are to be made without any withholding on account of tax. If a withholding is required by law then the party obliged to make the withholding must gross-up the payment so that the recipient receives the full gross amount.
 - **Sales tax:** The GMSLA 2009 clarifies that payments are exclusive of any sales tax and the party making the payment must pay any sales tax that applies to any supply to which such sums relate.
7. **Additional Borrower's Warranty:** The Borrower now warrants that it is not entering into any loan for the purpose of obtaining or exercising voting rights attached to the loaned securities.
8. **Assignment of amounts due on termination:** The prohibition on assignment has been amended to allow a party to transfer its rights in respect of (a) the net termination payment due following termination of the GMSLA and/or (b) any amount on account of expenses due to the Non-Defaulting Party pursuant to Clause 11.7 of the GMSLA. This is now similar to the position under the ISDA Master Agreement and allows parties to assign the net amount payable under the GMSLA only after set-off has been effected thereby preserving the mutuality of the parties for the set-off effected under Clause 11 post-default.
9. **Agency Annex:** The provisions for loans entered into as agent have been stripped out of the body of the GMSLA and are now in an Agency Annex which includes an addendum for "Pooled Principal Transactions" which enables an agent to enter into a stock loan on behalf of several principals, each of whom shall be responsible for only the part of the stock loan which is allocated to it.
10. **UK tax addendum:** The UK tax addendum for use where one of the parties is resident in the UK for tax purposes has been updated.

“The GMSLA 2009 allows a party to transfer its rights in respect of the net termination payment due following termination of the GMSLA, aligning the GMSLA with the position under the GMRA and the ISDA Master Agreement and allowing parties to assign the net amount payable under the GMSLA only after set-off has been effected.”

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