

## PART 11 - FOREIGN EXCHANGE TRANSACTIONS (Also see Part 25)

### What is a foreign exchange transaction (FX Transaction)?

[11.01] An FX Transaction is an agreement between two parties providing for the exchange or delivery of an amount of one currency for an amount of another currency.

**\*\*This part of the guide deals only with FX Transactions \*\***

The AFMA Guide to OTC Documents contains three master agreements which can be used for documenting spot or forward foreign exchange transactions. This part 11 contains commentary on how to use the ISDA Master Agreement for documenting spot or forward foreign exchange transactions.

In Volume 3 part 25 there are commentaries on and copies of:

- International Foreign Exchange Master Agreement 1997 version (see [25.02] - [25.15]), and
- AFMA's Master Agreement for Foreign Currency Transactions (see [25.16]).

### How to use this part of the guide

[11.02] **Have you used ISDA documents before?** If you are not familiar with the ISDA documents, we recommend that you:

- (a) read the User's Guide (~~see [Volume 2.02]~~) and the ISDA Master Agreement (~~see [Volume 2.01]~~);
- (b) read parts 3 and 5 of the guide;
- (c) read this part of the guide.

If you are familiar with the ISDA documents, we recommend that you start by reading this part and refer to the other parts as necessary.

As stated previously, this guide is prepared on the assumption that you use the 1992 ISDA Master Agreement.

### Preliminary issue

[11.03] **Do you want a separate ISDA Master Agreement?** Participants have the choice of using one ISDA Master Agreement for all Transactions including FX Transactions or using a separate ISDA Master Agreement for FX Transactions only.

We consider that using one agreement is preferable for the following reasons:

- (a) using one agreement for all Transactions simplifies documentation and reduces the number of agreements required;
- (b) it gives the parties the option of specifying net payments for corresponding payment dates for all Transactions giving them the ability to reduce the settlement risk with the counterparty; and
- (c) as all Transactions would then be regulated by the same agreement, the amount payable on early termination will be payable by reference to aggregate net exposures under all Transactions and therefore would not exclude amounts payable in connection with FX Transactions.

However, even where separate Master Agreements are used in respect of different kinds of Transactions, it is possible for the parties to provide that a single net amount will be payable between the parties should an Early Termination Event occur. Suggested wording to achieve this is contained in [18.22].

**Regulation.** See [6.04A] for commentary on the regulation of derivatives in Australia.

~~**Futures contracts.** Under the Corporations Law, trading in futures contracts is prohibited unless conducted on a futures exchange. Technically it is possible that non-deliverable foreign exchange transactions (See [11.05]) as well as certain swaps and other types of risk management transactions could be futures contracts within the meaning of the Corporations Law. The result depends on the facts in each case and can depend on the degree of standardisation of the contracts. Each participant in the financial markets must separately consider whether the prohibition under the Corporations Law applies to transactions to which it is a party.~~

~~On 15 November 1993 the Australian Securities Commission released Policy Statement 70 on exempt futures markets. The policy statement establishes an interim “safe harbour” in which certain futures market activities between sophisticated participants can take place with a minimum of regulation. Participants proposing to enter into transactions should decide whether the transactions are futures contracts and ascertain whether they should seek an exemption as a “regulated facility provider” or are entitled to trade with a regulated facility provider.~~

**Tax consequences.** This guide has not been prepared with a view to participants being able to achieve any particular tax consequence in entering into Transactions. Accordingly, participants must separately consider the tax consequences of following the recommendations in this guide.

## How to document FX Transactions

[11.04] To document FX Transactions under Australian law using the ISDA Master Agreement you should ensure that you have executed an ISDA Master Agreement with your counterparty. Recommendations for completing the schedule to an ISDA Master Agreement are set out in part 5 of this guide.

### [11.04A] Non Deliverable FX Transactions

The 1998 FX and Currency Option Definitions include the possibility of Non-Deliverable FX Transactions. At the time of updating this guide in September 1998, this product was not widely used in the Australian market and clear market conventions had not been adopted. While a suggested form of confirmation is included at [11.07](b), AFMA makes

no recommendations in respect of clauses for such products. Market participants intending to trade in this product should carefully review the 1998 FX and Currency Option Definitions in order to document their transactions. Note, in particular the warning at [12.02B](b) in respect of Disruption Events and Disruption Fallbacks. AFMA will update this guide as Australian market conventions develop.

#### [11.04B] **Disruption Events and Disruption Fallbacks**

The 1998 FX and Currency Option Definitions include Disruption Events and Disruption Fallbacks (see Article 5) which enable parties to agree alternative methods for settling Currency Options and FX Transactions on the occurrence of certain events.

Note that Article 5.1(e)(i) states that unless the parties otherwise agree:

- Disruption Events are deemed **not** to apply to Deliverable Transactions
- Price Source Disruption is deemed to apply to a Non-Deliverable Transaction.

Accordingly, parties should carefully consider whether this is acceptable and, if not, otherwise agree on the position to apply in respect to Disruption Events.

[11.04C] Until 1 January 2002 AFMA recommended using Australian Addendum No. 5 - Foreign Exchange Transactions. **This is no longer recommended for the following reasons:**

- (a) **Paragraph (1).** The designation by paragraph (1) of any foreign exchange transaction as a Transaction under the ISDA Master Agreement is **not** addressed by ISDA Definitions. Parties should carefully consider whether they require such a clause (it would be required if short form confirmations are used that do not specifically identify the transaction as a “Transaction”). [5.34](4) provides suggested wording for an equivalent of this paragraph. Parties wanting to use such a clause should include it in Part 5 of the Schedule to their ISDA Master Agreement.
- (b) **Paragraph (2).** This is not necessary if the relevant ISDA Definitions are expressly incorporated either in Confirmations or the Schedule to the ISDA Master Agreement. However, if they are not expressly incorporated, parties should carefully consider whether they require such a clause. [5.34](4) update provides suggested wording for an equivalent of this paragraph. Parties wanting to use such a clause should include it in Part 5 of the Schedule to their ISDA Master Agreement.
- (c) **Paragraph (3).** Unnecessary. International documentation practice is not to specifically deal with this in the ISDA Master Agreement and AFMA does not believe that the point justifies Australian ISDAs taking a different approach.
- (d) **Paragraph (4).** Unnecessary due to the way in which “Confirmation” is defined in the ISDA Master Agreement.

[11.05] **For historical comparison purposes**, behind the yellow sheet at [11.08] is a copy of Australian Addendum No. 5.

Our commentary on the paragraphs in this Addendum **that applied up to 31 December 2001** is as follows:

- (a) **General comment.** In June 1998 ISDA (along with two other groups) published the “1998 FX and Currency Option Definitions”. These Definitions are not contained in Volume 2 for copyright reasons. Participants wanting a copy of the

1998 FX and Currency Option Definitions can purchase them through AFMA. We have prepared Australian Addendum No. 5 on the basis that you need not refer to the 1998 ISDA FX and Currency Option Definitions in your Confirmations for FX Transactions. Previously, ISDA had published the “1992 ISDA FX and Currency Options Definitions”. The earlier versions of the Australian Addendum No. 5 did not rely on the 1992 ISDA FX and Currency Option Definitions. You can continue to use either the 1992 Definitions or earlier versions of the Australian Addendum. However, the 1998 FX and Currency Option Definitions provide definitions for a wider range of products and currencies. In particular they provide for non-deliverable FX Transactions. AFMA recommends you use the 1998 Definitions and the 1998 version of Australian Addendum No. 5.

Note that the Definitions now come in two parts, the Definitions and Annex A to the Definitions. It is anticipated that Annex A will be updated from time to time by ISDA. You may wish to state which version of Annex A applies to the transaction in the Confirmation. The first page of the Definitions gives you instructions how to do so. If the version of Annex A applying to the FX Transaction is not expressly stated in the Confirmation, the Definitions provide that the parties will be deemed to have incorporated Annex A as amended at the date on which parties enter into the relevant transaction.

- (b) **Paragraph (1).** This states that by incorporating Australian Addendum No. 5 in their ISDA Master Agreement the parties agree that every FX Transaction between them is governed by the ISDA Master Agreement whether or not its Confirmation refers to the ISDA Master Agreement or Australian Addendum No. 5 and whether or not the parties state in their confirmation that the FX Transaction is governed by the terms of any other master agreement.

The wording of paragraph (1) recognises the practical issues involved in making a change from documenting FX Transactions under an existing master agreement. It is drafted on an assumption that once two parties agree to add Australian Addendum No. 5 to their ISDA Master Agreement, all future FX Transactions between them are intended to be governed by the ISDA Master Agreement.

If you want FX Transactions entered into before you incorporate Australian Addendum No. 5 into your ISDA Master Agreement also to be governed by Australian Addendum No. 5, then you should include the following provision in part 5 of the Schedule to your ISDA Master Agreement:

- “( ) Despite anything contained in the attached September 1992 Australian Addendum No. 5 (as amended in March 1994 and September 1998) - Foreign Exchange Transactions, each FX Transaction (as defined in the 1998 FX and Currency Option Definitions published by International Swaps and Derivatives Association, Inc, the Emerging Markets Traders Association and the Foreign Exchange Committee) entered into between the parties before that addendum is incorporated in this Agreement is deemed to be a Transaction governed by the terms of that addendum and this Agreement. Paragraph (1) of that addendum applies to each such FX Transaction as if it were an FX Transaction referred to in that paragraph.”

Paragraph (1) recognises that at an operational level, there may still be instances, after the changeover, when Confirmations for FX Transactions either do not refer to the ISDA Master Agreement or continue to state that FX Transactions are governed by the terms of another master agreement. Paragraph (1) states that even in those circumstances the FX Transaction will be governed by the ISDA Master Agreement and not the other master agreement.

- (c) **Paragraph (2).** This incorporates the 1998 FX and Currency Option Definitions into each Confirmation.
- (d) **Deleted.**
- (e) **Paragraph (3).** This states that each FX Transaction is governed by the Australian foreign exchange market conventions and, if they are inconsistent with the 1998 FX and Currency Option Definitions, Australia conventions prevail. This includes business day conventions and rounding conventions (eg the business day convention is now Sydney only whereas the Definitions refer to Sydney and Melbourne).
- (f) **Paragraph (4).** This contains an acknowledgment of the various methods available for confirming FX Transactions and deems each to be a Confirmation.

It also contains the wording which is paragraph 1 of the Confirmation recommended by ISDA for FX Transactions (see Exhibit I to the 1998 FX and Currency Option Definitions (p.33)). This is designed to remove the necessity for placing, and recognises that it is impractical to place, these words on all types of Confirmations.

It also contains wording which recognises that standard terminology is not used in all types of Confirmations.

## Guide for completing Confirmations for FX Transactions

### [11.06] Preliminary comments

- (a) [5.34](4) contains a suggested clause which can be used so that existing procedures for confirming FX Transactions need not be changed as a result of parties agreeing that their ISDA Master Agreement is to govern FX Transactions between them.

However, if you use a form of Confirmation which states that the FX Transaction is governed by the terms of a particular master agreement, then we recommend that you change the form of that Confirmation so that it refers to the ISDA Master Agreement.

- (b) **Confirmation methods.** The following methods can be used to confirm. It is up to the parties to agree which method or methods they will use:

Telephone  
Reuters direct dealing system  
Telerate trading service  
Telex  
FINE  
SWIFT MT300 message

Other electronic services or messaging systems

Letter

Facsimile

At [11.07] there is a recommended procedure for letters. Essentially, they reproduce the Exhibits in the 1992 FX and Currency Option Definitions. However, this wording and all confirmation procedures must be completed in accordance with market conventions and it is recognised that in the large majority of cases letter confirmation will not be used for confirming FX Transactions.

- (c) **Have you signed an ISDA Master Agreement?** Although not recommended, it is recognised that Transactions might be entered into before the parties have signed an ISDA Master Agreement. If that is the case, we recommend that you insert the following paragraph in the Confirmation or exchange letters agreeing to the substance of the following:

“You and we agree promptly to negotiate and sign a 1992 multicurrency - cross border version of the ISDA Master Agreement (as published by International Swaps and Derivatives Association, Inc.). Once an agreement based on that document is signed, this Confirmation is to supplement, form part of, and be subject to that agreement as amended and supplemented from time to time. All provisions contained in that agreement govern this Confirmation except as expressly modified below.

Until the agreement is signed, this Confirmation supplements, forms part of, and is subject to the terms contained in that document as if you and we had signed that document without amendment except that:

- (a) the Termination Currency is to be Australian dollars; and
- (b) the Governing Law is to be the laws of the state of [New South Wales].”

You must appreciate that this is not a complete substitute for signing an ISDA Master Agreement because there are numerous variables in the ISDA Master Agreement which will not operate until an election has been made. These are easily identified by looking through the Schedule to the ISDA Master Agreement. You should negotiate and sign an ISDA Master Agreement as soon as possible after adopting this approach.

[11.07] **Letters**

Suggested form of letter:

(a) Suggested form of letter - Deliverable FX Transactions:

[Letterhead of Party A]	[Date]
[Name and Address of Party B]	
Dear	
<b>Foreign Exchange Transaction</b>	
The purpose of this letter is to confirm the terms and conditions of the Deliverable FX Transaction entered into between us on the Trade Date specified below (the "Transaction"). This letter constitutes a "Confirmation" as referred to in the Master Agreement specified below.	
The definitions and provisions contained in the 1998 FX and Currency Option Definitions ( as published by the International Swaps and Derivatives Association, Inc, the Emerging Markets Traders Association and the Foreign Exchange Committee), are incorporated into this Confirmation. In the event of any inconsistency between those definitions and provisions and this Confirmation, this Confirmation will govern.	
1.	This Confirmation supplements, forms a part of, and is subject to the Master Agreement dated as of [insert date], as amended and supplemented from time to time between [Name of Party A] ("Party A") and [Name of Party B] ("Party B") (the "Agreement"). All provisions contained in the Agreement govern this Confirmation except as expressly modified below.
2.	The terms of the Transaction to which this Confirmation relates are as follows:  (a) General Terms:  Trade Date: [Amount and currency payable by Party A] [Amount and currency payable by Party B] Settlement Date:
3.	Calculation Agent:
4.	Account Details:  Account for payments to Party A:  Account for payments to Party B:
5.	Offices  The Office of Party A for the Transaction is ;  The Office of Party B for the Transaction is ;

6. [Business Day:]

7. [Business Day Convention:]

This Confirmation supersedes and replaces any other confirmation (including a SWIFT MT300 or telephone confirmation), if any, sent in connection with this Transaction on or prior to the date hereof.

Please confirm that the foregoing correctly sets forth the terms of our agreement by executing the copy of this Confirmation enclosed for that purpose and returning it to us or by sending to us a letter substantially similar to this letter, which letter sets forth the material terms of the Transaction to which this Confirmation relates and indicates your agreement to those terms.

Yours sincerely  
[name of party preparing Confirmation]  
By:  
Name:  
Title:

Confirmed as of the date first written:  
[name of other party]  
By:  
Name:  
Title:

(b) Suggested form of letter - Non - Deliverable FX Transactions:

[Letterhead of Party A]

[Date]

[Name and Address of Party B]

Dear

**Foreign Exchange Transaction**

The purpose of this letter is to confirm the terms and conditions of the Non-Deliverable FX Transaction entered into between us on the Trade Date specified below (the "Transaction"). This letter constitutes a "Confirmation" as referred to in the Master Agreement specified below.

The definitions and provisions contained in the 1998 FX and Currency Option Definitions ( as published by the International Swaps and Derivatives Association, Inc, the Emerging Markets Traders Association and the Foreign Exchange Committee), are incorporated into this Confirmation. In the event of any inconsistency between those definitions and provisions and this Confirmation, this Confirmation will govern.

1. This Confirmation supplements, forms a part of, and is subject to the Master Agreement dated as of [insert date], as amended and supplemented from time to time between [Name of Party A] ("Party A") and [Name of Party B] ("Party A") (the "Agreement"). All provisions contained in the Agreement govern this Confirmation except as expressly modified below.
2. The terms of the Transaction to which this Confirmation relates are as follows:



(a) General Terms:

Trade Date:  
Reference Currency:  
[Reference Currency Notional Amount:]  
[Notional Amount:]  
[Forward Amount:]  
Reference Currency Buyer:  
Reference Currency Seller:  
Settlement Currency:  
Settlement Date:  
Settlement:  
[Settlement Rate:][Settlement Rate Option:]  
Valuation Date:

[(b) Other terms and conditions eg reference to Disruption Events and Disruption Fallbacks - see Exhibit II-E to 1998 FX and Currency Option Definitions]

3. Calculation Agent:

4. Account Details:

Account for payments to Party A:

Account for payments to Party B:

5. Offices

The Office of Party A for the Transaction is ;

The Office of Party B for the Transaction is ;

6. [Business Day:]

7. [Business Day Convention:]

This Confirmation supersedes and replaces any other confirmation (including a SWIFT MT300 or telephone confirmation), if any, sent in connection with this Transaction on or prior to the date hereof.

Please confirm that the foregoing correctly sets forth the terms of our agreement by executing the copy of this Confirmation enclosed for that purpose and returning it to us or by sending to us a letter substantially similar to this letter, which letter sets forth the material terms of the Transaction to which this Confirmation relates and indicates your agreement to those terms.

Yours sincerely  
[name of party preparing Confirmation]

By:  
Name:  
Title:

Confirmed as of the date first written:  
[name of other party]

By:  
Name:  
Title: