ISDA

International Swaps and Derivatives Association, Inc.
One New Change
London, EC4M 9QQ
Telephone: 44 (20) 7330 3550
Facsimile: 44 (20) 7330 3555
email: isda@isda-eur.org
website: www.isda.org

[addressee]

[date]

Re: New ISDA Equity Derivatives 'Definitions'

Dear Colleague,

Please find enclosed a courtesy copy of the recently published "ISDA 2002 Equity Derivatives Definitions" (the "Definitions"). As you will see from the introduction to this document, the new Definitions are an update of the widely used 1996 ISDA Equity Derivatives Definitions.

The main purpose of this letter is simple: to stress the evolutionary nature of the changes to the provisions that ISDA has made in producing this new set of Definitions. We believe that this fact may be of relevance in relation to amendments which may be need to be made to an number of our members' securitised equity derivatives programmes (warrants, certificates and equity linked notes) listed on various exchanges - since the terms and conditions of these listed forms of derivative often mirror the industry-standard definitions in use in the OTC equity derivatives markets as published by ISDA from time to time.

We have therefore been asked to write to you to:-

(a) provide an outline of the principle changes to terms; and
(b) advise you that we are aware that a number of our members may shortly be approaching you to effect amendments to the terms and conditions of their listed securitised derivatives programmes in light of the implementation of the new Definitions.

The specific focus of the amendments made in producing the Definitions is set out in in the introduction to the document. What will be apparent from this is that changes fall into one of three broad categories: 1) extended product coverage; 2) changes with economic impact, particularly with regards to adjustments to be effected in response to corporate actions; and 3) technical amendments. In each case, the new material builds on existing provisions and practice developments in the markets.

Taking each of these types of change in order:

1) Extended product coverage

The extended product coverage is designed to allow parties to easily document a fuller range of OTC instruments under an ISDA Master Agreement. Thus the Definitions specifically mention: forwards; Bermuda-style options; and knock-in and knock-out transactions. The Definitions continue to be applicable to options and swaps on single shares, indices and baskets. Some of these changes (for example knock-in and knock-out provisions) may be relevant to listed securitised derivatives programmes whilst others (for example the provisions relating to forward transactions) will not.

2) Changes with economic impact

The changes encompassed in this category represent a refinement of existing mechanisms and a formalisation of developed market practice. Thus the range of "Consequences of Merger Events" that parties using the Definitions may choose from is broadened and some of those Consequences have been updated to better reflect market practice. However, the fundamental objective remains the same – to support the parties' ability to react in a commercially appropriate manner to an established type of event that has a material impact on the transaction, namely mergers, tender offers and other forms of corporate action.

We are aware that individual exchanges have very different approaches to corporate actions and some of the provisions in the Definitions dealing with this will not be relevant to exchange listed programmes. For example, a co-calculation agent / adjustment by agreement between issuer and holder mechanism would not be applicable in the context of publicly traded securities. However, the events which constitute actions giving rise to a right to amend or adjust the terms of the derivative (particularly the tender offer provisions) will potentially be of relevance to listed securitised equity derivatives as well as derivatives transacted in the OTC markets.

3) Technical Amendments

As the name suggests, this category of change is narrowly focused. It includes a reworking of some of the settlement provisions, such that parties may choose physical settlement or cash settlement to apply to a fuller range of transactions. The definition of business days has been clarified, as have the criteria for determining a disrupted day. Similarly, the definition of dividend amounts is now more granular.

In conclusion, we believe that all of the above, while consituting a significant improvement in the documentation, does not fundamentally alter its purpose or logic.

We hope that this information is of use in highlighting the nature of the changes introduced in the Definitions and will be happy to entertain any questions you may have on this new ISDA documentation.

Yours sincerely,

Richard Metcalfe
Co-Head of European Office