HSBC

# Deemed ISDA Master Agreement disclosure note

We are in the process of establishing a trading relationship to enable the trading of derivatives between us. If we trade a derivative with you, we will send you a confirmation which will set out all the key details of the relevant trade. As well as the economic terms, the confirmation will also make the trade (and potentially other trades that may be executed in the future) subject to the terms of a 2002 ISDA Master Agreement (the '**ISDA MA**'), that will be deemed to apply between us.

**The purpose of this note is to highlight in summary form the material provisions of the ISDA MA. It does not constitute legal advice, and if you are uncertain about any of the content below or the terms of the ISDA MA that will be deemed to apply, we recommend you take your own advice, legal, accounting or otherwise.**

**Background:**

The ISDA MA is the market-standard contract for trading derivatives. It is a netting agreement that is published by ISDA (The International Swaps and Derivatives Association, Inc) and is designed to apply to over-the-counter derivatives such as interest rate or foreign currency transactions, including swaps, caps, options and forwards.

The ISDA MA governs the legal and credit relationship between two parties. It includes, amongst other things, representations, termination provisions and netting mechanics. These provisions are summarised below.

The ISDA MA is essentially a standard-form bilateral contract for parties to deal with each other on a principal to principal and arm's length basis. If the parties wish to amend or add to these terms they do so in a negotiated schedule to the ISDA MA. In deeming an ISDA MA into place between us, we are thus trading on the basis of an unamended ISDA MA. This may be considered appropriate in certain circumstances, for instance, where you do not wish to negotiate a schedule to the ISDA MA, or the derivative products we are trading with a counterparty are relatively simple and/or short-dated.

ISDA has produced a wide array of supporting materials for the ISDA MA, including definitions for use in confirmations and user's guides. These are designed to give further detail on the specific terms of the transactions agreed between us, and to provide consistent use and interpretation of the ISDA MA.

We recommend that you review these materials, in consultation with your independent professional (including legal) advisers as you deem necessary. The definitions produced by ISDA are regularly updated to reflect the most recent regulatory or market changes.

You can find a copy of the ISDA MA at the following link: https://www.gbm.hsbc.com/financial-regulation/2002-isda-master-agreement. Any term capitalised but not otherwise defined herein has the meaning given to it in the ISDA MA.

**Main Contractual provisions:**

**(A) Single Agreement:**

As noted above, the ISDA MA is first and foremost a netting agreement. A key concept is set out in section 1(c) of the ISDA MA – that all transactions between the parties are essentially part of a single agreement under the ISDA MA. This is to enable to netting benefits described below in (E).

**(B) General Obligations:**

Section 2 sets out the obligations of the parties, primarily to pay or deliver whatever they are obliged to with respect to any transactions that have been entered into. There is an important condition to a party's obligations, namely that each payment obligation of that party to the agreement is conditional that there has been no Event of Default or Potential Event of Default with respect to the other party which has occurred and is continuing. If the other party is in default or in potential default then the first party is not obliged to perform its own obligations.

**(C) Representations:**

In section 3 each party gives the other some basic representations pertaining to its capacity and authority to enter the ISDA MA and any transaction, and the legal enforceability of the contract.

**(D) Events of Default, Termination Events:**

Section 5 includes a range of rights that enable one or more party to terminate all or some transactions based on specific events. A number of these are similar to other commercial contracts, like a loan agreement – for instance the Failure to Pay and Bankruptcy Events of Default are fairly normal in any contract in which the parties have ongoing obligations to each other.

As well as Events of Default there are other events (called 'Termination Events') which cover non-fault based events, like changes in law or tax regulation, for which a termination of the affected trades may be the best solution. The right to terminate, and the basis on which the termination is valued, may differ depending on the nature of the event.

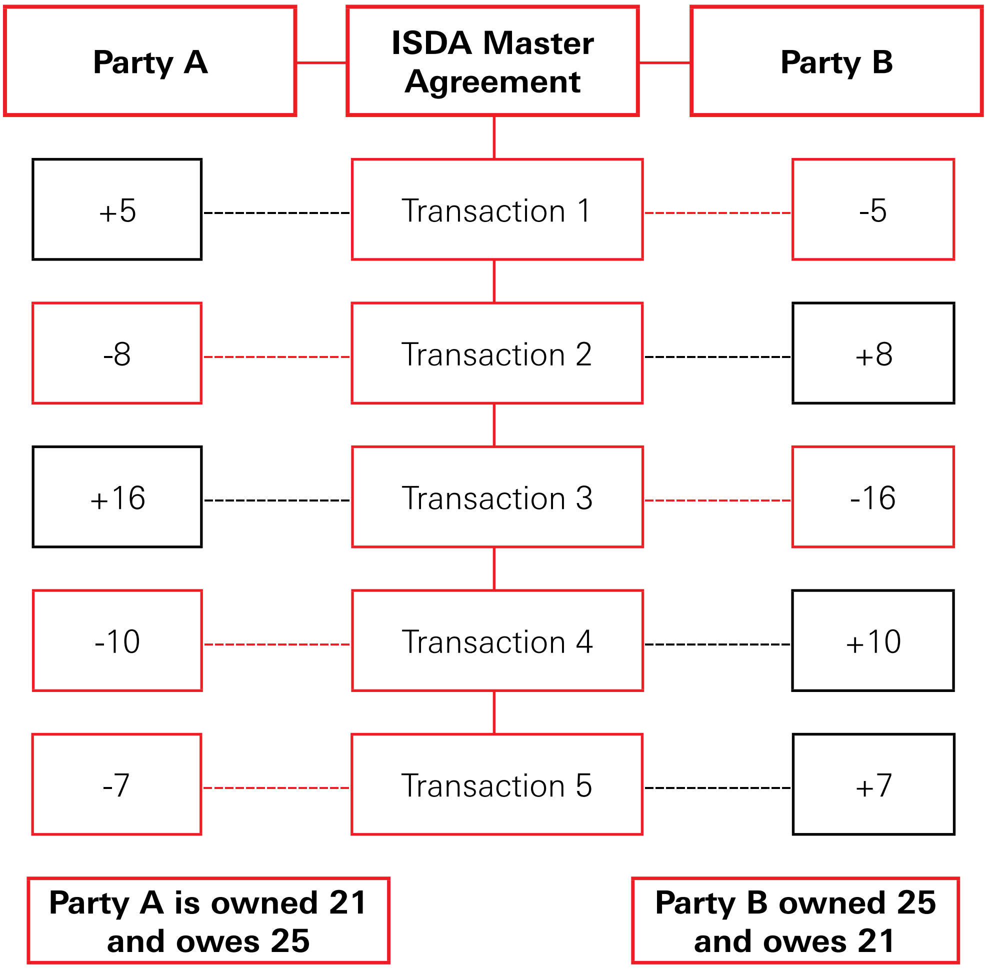
**(E) Close-out netting:**

The netting mechanics of the ISDA MA are the primary benefit for the parties in using an ISDA MA as it potentially enables the parties to treat multiple exposures under existing transactions on a net rather than gross basis, which potentially reduces credit exposure if that entity defaults.

If an Event of Default has occurred and the Non-Defaulting Party has exercised its right to terminate, it will calculate a single net amount, which will be due and payable by one party to the other. It will calculate this single amount by valuing all of the transactions governed by the ISDA MA and netting them all together. The resulting net number will be the termination amount.

Following a Termination Event, either party (depending on the precise event) may have the option to terminate, and it may be that the termination amount is effectively calculated by each party independently, with the two net numbers averaged to determine the final termination amount.

**The below example illustrates the value of netting.**




**<u>ON PARTY B'S INSOLVENCY</u>**

**WITH NETTING:** Party A owes 4 to Party B
**WITHOUT NETTING:** Party A would have to pay 25 to Party B and enter a bankuptcy claim of 21.

It is important to recognise that all transactions under an ISDA MA have an inherent value, and an early termination will lead to the net amount of that value becoming payable from one party to the other. The value of a particular transaction is largely a function of how the underlying rate or value to which the derivative relates (e.g. interest or FX rates) has moved since the execution of the relevant transaction, as well as expected future rate moves. In determining the value of a transaction, the expected price or forward rate, volatility, interest rates, valuation model or method and other relevant market data may be taken into account.

It is also relevant to note that HSBC may hedge any transaction or transactions between us with market counterparties. If our transaction(s) with you are terminated in whole or in part, we may need to amend any hedge positions accordingly. Given the inherent value of these transactions, we may have to pay our hedge counterparty to terminate or adjust the hedge. The unwind cost that may be payable by you in such circumstances will be similar to the costs arising from terminating or adjusting such hedge positions.

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The basis on which an early termination of a trade is calculated is essentially the same as that applied following defaults and termination events. Prior to entering any transaction with us we may share scenario analyses with you to illustrate what the costs could be in a range of scenarios.

### (F) Set-off

The ISDA MA also includes a set-off clause. Whilst similar in function to the netting mechanics (insofar as both provisions operate to reduce an amount owing by lesser amounts) the benefit of this clause is that it permits an early termination amount to be set-off against other payments the parties may owe each other outside of the ISDA MA.

Thus, in the above example we saw that the net amount owing in Party B's insolvency was 4, owed by Party A. If Party A has made a loan to Party B, under which Party B owes 10 to Party A, then these two amounts can be set off to reduce the overall claim to 6 (i.e. 10 less 4).

Set-off is a similar mechanism to netting but they have a slightly different legal character which can lead to different outcomes in different jurisdictions.

## Conclusion

This is a very high-level summary of the ISDA MA, designed to highlight the key terms and their relevance to the parties. As part of the onboarding process we share with you other materials that are of relevance to our trading relationship, such as our Terms of Business and our Terms of Dealing. If you have any questions on any of these documents, please do not hesitate to contact your usual HSBC representative and they will direct your query to the appropriate place.

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The instruments we may trade under the ISDA MA (as defined above) are not readily realisable investments; it may also be difficult to obtain reliable information about their value or the extent to which you are exposed. Investments can fluctuate in price or value and prices, values or income may fall against an investor's interests. Changes in rates of exchange and rates of interest may have an adverse effect on the value, price or income of these investments. The levels and bases of taxation can change. Derivatives can be utilised for the management of investment risk, however, derivative instruments may not be suitable for all investors, as they may be contingent liability transactions such as swaps. This means that you may not only lose all the amount invested but may also have to pay an additional sum at a later date. You should ensure that you read the applicable standard risk warning in conjunction with this document, and where necessary seek advice.

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