

Credit Supernova

ISDA publishes 2014 ISDA Credit Derivatives Definitions

Introduction

If 2009 saw the 'big bang' and 'small bang' of the credit derivatives market then 2014 sees the 'supernova' – the biggest overhaul of the Credit Derivatives Definitions in over a decade. The 2014 Credit Derivatives Definitions include a new Credit Event for government bail-ins and revised deliverable obligation provisions to provide for 'asset package' delivery. They also incorporate numerous other changes to address issues which have come to light during recent credit events and succession events, and during discussions on the potential impact of a break-up of the Eurozone on the credit derivatives market. ISDA¹ has also taken the opportunity to refine many of the current definitions, in certain places simplifying and consolidating the existing complex provisions, to produce a revised set of definitions which represent a considerable improvement to the 2003 Credit Derivatives Definitions.²

This briefing highlights some of the key new definitions and provisions contained in the 2014 Credit Derivatives Definitions³ and outlines the background to these changes. In particular we consider:

- > the new Governmental Intervention Credit Event;
- > the new Asset Package Delivery provisions;
- > the treatment of senior and subordinated credit default swaps (**CDS**) for financial Reference Entities;
- > the new Universal Successor and Standard Reference Obligation provisions and changes to the terms relating to Obligations and Deliverable Obligations; and
- > changes to the Restructuring Credit Event provisions and the new definition of Outstanding Principal Balance.

¹ The International Swaps and Derivatives Association, Inc. (**ISDA**)

² The 2003 ISDA Credit Derivatives Definitions as supplemented by the July 2009 Supplement (the **2003 Definitions**).

³ The 2014 ISDA Credit Derivatives Definitions, published on 21 February 2014 (the **2014 Definitions**). The July 2009 Supplement provisions have been consolidated into the 2014 Definitions. Capitalised terms used in this briefing refer to the defined term from the 2003 Definitions and/or 2014 Definitions as the context requires.

When do I need to start using the 2014 Definitions?

- > All market standard CDS entered into from the roll date in September 2014 will be documented using the 2014 Definitions.
- > ISDA is expected to: (i) publish a protocol to allow parties to amend their existing transactions to incorporate some of the changes and new provisions from the 2014 Definitions; and (ii) amend supporting documentation that currently reference the 2003 Definitions.
- > A bifurcated market is expected to exist in the short term. Issuers and arrangers of credit linked notes should consider the impact of the 2014 Definitions on the terms, availability and cost of hedging transactions (both existing and new) and whether to amend programme documentation for the 2014 Definitions.

Bail-ins, Financial Reference Entities and Restructuring

1. Governmental Intervention

Background: Government bail-ins of bank debt have tested the limits of the current Restructuring Credit Event. A case in point was the Credit Event in respect of the Dutch bank SNS Bank NV (**SNS**). SNS was nationalised and its subordinated bonds expropriated as part of a government bail-in. As expropriation is not one of the events expressly contemplated by the definition of Restructuring in the 2003 Definitions, there was uncertainty as to whether a Restructuring Credit Event had occurred.⁵

The market has been further spurred into action by the bail-in provisions set out in the EU Bank Recovery and Resolution Directive (the **BRRD**).⁶ The new bail-in provisions, which are currently expected to apply from 1 January 2016, will allow the relevant European government to impose a mandatory write down or exchange of debt on senior as well as subordinated bondholders and will make bail-in of a minimum of 8% of a bank's liabilities a prerequisite to a government bail-out.

New Credit Event: The solution has been to include a separate Credit Event in the 2014 Definitions addressing government bail-ins, thereby removing the need to consider whether bail-in related events fall under the Restructuring Credit Event. The new Credit Event, Governmental Intervention,⁷ can be triggered where, as a result of the action or announcement of a Governmental Authority pursuant to, or by means of, a restructuring and resolution law or regulation applicable to the relevant Reference Entity, certain binding changes are made to relevant Obligations of the Reference Entity. The new Credit Event covers changes such as reductions (including by way of redenomination) and deferrals in interest and/or principal, the subordination of the relevant Obligation, expropriations, transfers and other events which mandatorily change the beneficial holder of the relevant Obligation, mandatory cancellations, conversions and exchanges and other analogous events.

Whilst there is a degree of overlap between a Restructuring Credit Event⁸ and the new Governmental Intervention Credit Event (e.g. a reduction (including by way of redenomination) in the amount of interest or principal payable under an Obligation is a specified event under both the Restructuring and Governmental Intervention Credit Events), there are some crucial differences.

Governmental Intervention:

- > **Governmental Intervention** is a new Credit Event under the 2014 Definitions.
- > It covers changes to the terms of relevant obligations of a Reference Entity resulting from the action or announcement of a Governmental Authority pursuant to a restructuring and resolution law or regulation applicable to the Reference Entity.
- > Compared to the Restructuring Credit Event, it covers a broader range of changes which may be made to the terms of an obligation and does not include the deterioration in creditworthiness restriction or Multiple Holder Obligation requirement.
- > Debt with a bail-in provision written into its terms will now qualify as a Deliverable Obligation, notwithstanding such term might otherwise cause it to fail one of the Deliverable Obligation Characteristics.
- > Express write-down provisions contemplating a bail-in will not be taken into account when calculating the Outstanding Principal Balance of a Deliverable Obligation.⁴

⁴ See paragraph 11 below for further information on the definition of Outstanding Principal Balance.

⁵ On a purposive construction the expropriation was treated as a reduction in principal within limb (a)(ii) of the definition of Restructuring Credit Event in the 2003 Definitions, even though there was some uncertainty about whether the bonds expropriated were actually cancelled and, in any case, the Multiple Holder Obligation requirement was not satisfied when in the Dutch government's possession.

⁶ Political agreement of the European Council and the European Parliament on the compromise text of the proposed Directive of the European Parliament and Council establishing a framework for the recovery and resolution of credit institutions and investment firms was reached in December 2013. The BRRD is currently expected to enter into force on 1 January 2015 with the bail-in provisions expected to apply from 1 January 2016.

⁷ Section 4.8 of the 2014 Definitions. The intention is that Governmental Intervention will apply to CDS to which the new 'Financial Reference Entity Terms' are specified to apply in the confirmation. See paragraph 2 below.

⁸ Section 4.7 of the 2014 Definitions.

A Restructuring Credit Event can only be triggered when the relevant change results from a deterioration in the creditworthiness of the Reference Entity, and, where Multiple Holder Obligation applies, at the time of the relevant event the Obligation being restructured must meet the requirements for a Multiple Holder Obligation, whereas neither of these requirements need to be met for a Governmental Intervention Credit Event.⁹ A further example is the restriction which prevents a Restructuring Credit Event being triggered where the relevant write-down or amendment to the obligation is expressly contemplated by the terms of the obligation.¹⁰ In light of the BRRD, it may become more common for the terms of bank bonds to expressly contemplate a bail-in and therefore be caught by this restriction. Governmental Intervention also covers a broader list of amendments to the terms of an Obligation, including an expropriation (e.g. SNS), a change in the beneficial holder and a mandatory cancellation, conversion or exchange, all of which may result from a bail-in but are not expressly contemplated in the definition of Restructuring in the 2003 Definitions or the 2014 Definitions.¹¹

2. Financial Reference Entity Terms and Subordinated/Senior Split

Background: Under the 2003 Definitions, a Restructuring Credit Event occurring in respect of subordinated debt will trigger the protection on all CDS, including senior CDS (i.e. a CDS referencing a non-subordinated Reference Obligation). This was the case for SNS where, notwithstanding that the expropriation did not extend to the senior debt, the determination of a Restructuring Credit Event in respect of the subordinated debt led to all CDS referencing SNS being triggered.

The successor provisions in the 2003 Definitions apply across the board as well, even if the transfer of debt only relates to subordinated debt. This can lead to an unexpected change of Reference Entity if a subordinated CDS is amended to reference the new entity to which the senior debt has been transferred even though the subordinated debt is left behind with the original Reference Entity.¹²

Financial Reference Entity Terms: The 2014 Definitions introduce a new concept of Financial Reference Entity Terms which may be specified in the confirmation for a CDS. Application of the Financial Reference Entity Terms

Financial Reference Entity Terms:

- > The 2014 Definitions include a new concept of **Financial Reference Entity Terms** which may be specified in the confirmation for a CDS.
- > Where Financial Reference Entity Terms are specified, the senior and subordinated CDS for a Reference Entity are treated independently of each other for the purposes of Governmental Intervention and Restructuring Credit Events and when determining the relevant Successor(s).

⁹ Section 4.10 of the 2014 Definitions.

¹⁰ Sections 3.11(a)(v), 3.15(f) and 3.21(b)(v)(4) of the 2014 Definitions.

¹¹ Notwithstanding that such events are not expressly specified in the definition of 'Restructuring' in the 2003 Definitions or the 2014 Definitions, some of these events may, depending on the manner of the implementation and a purposive construction, result in the occurrence of a Restructuring Credit Event.

¹² This was the case on the Bankia S.A. (**Bankia**) Succession Event. Banco Financiero y de Ahorro (**BFA**) and its subsidiary Bankia were set up to for the purpose of consolidating the operations of seven Spanish regional savings banks (cajas). There were two steps to the restructuring: (a) a transfer of all debt from the cajas to BFA; and (b) a transfer of the senior debt and a small portion of the subordinated debt from BFA to Bankia. For both the senior and the subordinated CDS written on the cajas (in particular Caja Madrid and Bancaja), the Successor was Bankia, notwithstanding that most of the subordinated debt was actually with BFA. Subsequently, the Caja Madrid subordinated Reference Obligation matured on 10 April 2012 resulting in no subordinated bonds being deliverable into subordinated CDS on Bankia referencing such Caja Madrid subordinated Reference Obligation, because Bankia had no subordinated obligations to meet the Deliverable Obligation requirements under the subordinated CDS.

to a CDS will switch on and/or impact the application of certain provisions in the 2014 Definitions. For the purposes of this briefing we refer to a Reference Entity to which Financial Reference Entity Terms apply in the confirmation for the CDS as a **'Financial Reference Entity'**.¹³

New approach to treatment of senior and subordinated CDS: Under the 2014 Definitions subordinated CDS of Financial Reference Entities have been separated from senior CDS in certain (but not all) circumstances.

Where Financial Reference Entity Terms are applied to a CDS for which the relevant Reference Obligation is a senior obligation, and a Governmental Intervention or Restructuring Credit Event occurs in respect of subordinated debt, only the protection on the subordinated CDS will be triggered. For the protection on the senior CDS to be triggered a Governmental Intervention or Restructuring Credit Event would need to occur in respect of the senior debt.¹⁴ For all other Credit Events, the position remains the same as under the 2003 Definitions with the protection under both senior and subordinated CDS being triggered.

There has been a further split of subordinated and senior CDS when determining successor Reference Entities for a Financial Reference Entity. The subordinated CDS will follow the subordinated debt and the senior CDS will follow the senior debt such that if the senior debt and the subordinated debt are transferred to two different entities, the subordinated CDS and senior CDS will subsequently reference different Reference Entities.¹⁵

3. Asset Package Delivery

Background: Another issue under the 2003 Definitions is the potential lack of any Deliverable Obligations following a restructuring which is implemented by way of exchange of debt, or, as in the case of SNS, an expropriation of all of the debt. Following the expropriation of all of the SNS subordinated bonds, the Auction Final Prices were determined by reference to the value of the senior bonds giving a high recovery rate,¹⁶ even though holders of the subordinated bonds had suffered a complete loss of principal.

This has also been a concern in the context of Sovereign restructurings. In the Greece Restructuring Credit Event the Greek government effected a mandatory exchange of the old domestic law bonds for a package of new domestic law bonds, GDP-linked bonds and EFSF bonds, which was implemented just one business day after the exchange became legally binding.¹⁷ Fortunately for buyers of CDS referencing Greece, some of the

¹³ We understand that the intention is for a new 'European Financial Corporate' Transaction Type to be added to the ISDA Credit Derivatives Physical Settlement Matrix for Reference Entities specifying Governmental Intervention and Financial Reference Entity Terms as applicable.

¹⁴ Section 3.6(b) and (c) of the 2014 Definitions. This is achieved via the application of the Excluded Obligation concept. Note that for subordinated CDS, obligations subordinated to the Subordinated Obligation (**Further Subordinated Obligations**) are also excluded.

¹⁵ Section 2.2(f)(iii) and (iv) of the 2014 Definition.

¹⁶ Two Auctions were held with recovery rates of 95.5% ('bucket' 1: 0-2.5 years maturity) and 85.5% ('bucket' 6: 12.5-15 years maturity), with no auctions held for intermediate 'buckets'.

¹⁷ Each €1,000 in principal amount of old domestic law bonds was exchanged for €315 in principal amount of new domestic law bonds (20 separate issues), €315 in principal amount of gross domestic product-linked Bonds (**GDP-linked bonds**) and €150 in principal amount of bonds issued by the European Financial Stability Facility (**EFSF bonds**).

Asset Package Delivery:

- > The 2014 Definitions introduce new Asset Package Delivery provisions.
- > Asset Package Delivery will, subject to certain criteria, apply following an Asset Packaged Credit Event.
- > An Asset Package Credit Event is a:
 - (i) Governmental Intervention in respect of a Financial Reference Entity;
 - (ii) Restructuring Credit Event in respect of the Reference Obligation of a Financial Reference Entity where such Restructuring does not constitute a Governmental Intervention; or
 - (iii) Restructuring Credit Event in respect of a Sovereign.

new domestic law bonds constituted Deliverable Obligations¹⁸ and were valued in the Auction at a similar price to that at which the old domestic law bonds were trading pre-exchange so the holders of CDS got roughly the right result.¹⁹ The potential for difficulties in this area was, however, evident.

New Asset Package Delivery provisions: This concern has been addressed by the new Asset Package Delivery provisions in the 2014 Definitions which, subject to certain criteria, apply following an Asset Package Credit Event.²⁰ A Governmental Intervention in respect of a Financial Reference Entity, a Restructuring Credit Event in respect of a Sovereign Reference Entity and a Restructuring Credit Event in respect of the Reference Obligation of a Financial Reference Entity where such Restructuring does not constitute a Governmental Intervention are each Asset Package Credit Events.²¹

Following a Governmental Intervention in respect of a Financial Reference Entity, provided there was a **Prior Deliverable Obligation** (i.e. an existing obligation of the Reference Entity which, immediately prior to the relevant bail-in event to which such obligation is subject, constituted a Deliverable Obligation) the assets which result from such Prior Deliverable Obligation following the bail-in will be deliverable into the relevant Auction or under a CDS.²² Consequently, it is this resulting asset package which will determine the Auction Final Price. This will apply even if there are effectively no resulting assets because, for example, the bonds have been expropriated. In this situation, the asset package is deemed to be zero. So, if another SNS type expropriation were to occur, the subordinated CDS protection buyer would receive a 100% payment under their CDS because the asset package which they can deliver has a value of zero.

Where a Restructuring Credit Event occurs in respect of a Sovereign Reference Entity, the asset package will be based not on the Prior Deliverable Obligation but on what is referred to as a **Package Observable Bond** (i.e. a benchmark obligation of the relevant Sovereign which is identified by ISDA for these purposes and published on its website). Note that the Package Observable Bond must have constituted a Deliverable Obligation immediately preceding the date on which the relevant Asset Package Credit Event was legally effective.²³ The list of Package Observable Bonds for a particular Sovereign will be selected in accordance with criteria to be set out in the Credit Derivatives Determinations Committee Rules (the **DC Rules**²⁴) and published on the ISDA website.²⁵ The rationale for the

Asset Package Delivery:

- > The consequences of Asset Package Delivery applying are that where:
 - (i) Financial Reference Entity Terms and Governmental Intervention apply to a CDS and a debt exchange results in a Prior Deliverable Obligation being transformed into non-Deliverable Obligations,
 - (ii) a Restructuring Credit Event occurs in respect of Sovereign Reference Entity and a debt exchange results in a Package Observable Bond being transformed into non-Deliverable Obligations, or
 - (iii) the resulting assets (the Asset Package) will, in the absence of any other restrictions on delivery, be deliverable under the CDS or into the Auction.

¹⁸ Along with the international law bonds and guaranteed bonds.

¹⁹ The Auction Final Price was 21.5%.

²⁰ Section 8.8 of the 2014 Definitions. Asset Package Delivery will apply if an Asset Package Credit Event occurs unless (i) the Asset Package Credit Event occurs prior to the relevant Credit Event Backstop Date determined in respect of the Credit Event specified in the Credit Event Notice or DC Credit Event Announcement applicable to the Event Determination Date or (ii) the Reference Entity is a Sovereign and no Package Observable Bond exists immediately prior to the relevant Asset Package Credit Event.

²¹ Section 8.9 of the 2014 Definitions.

²² Sections 3.2(d) and 3.3 of the 2014 Definitions.

²³ Sections 3.2(d) and 3.4 of the 2014 Definitions.

²⁴ The DC Rules are available at www.isda.org/credit/reviseddcrules.html.

²⁵ Or published by a third party on another website designated by ISDA for this purpose. Section 3.4 of the 2014 Definitions.

introduction of the Package Observable Bond is the desire to reduce the risk of moral hazard relating to concerns that bondholders in a Restructuring are incentivised differently where they have CDS protection when agreeing to the terms of a consensual restructuring. Package Observable Bonds seek to address this concern by ensuring that only widely held bonds with significant outstanding principal balances will result in a deliverable Asset Package. This should result in a wider diversity of the bondholders and thereby reduce the risk of bondholders with CDS protection agreeing to a 'poor' deal in a Restructuring.

Having conceived a solution to government bank bail-ins, there arose another scenario which fell outside these provisions which needed to be addressed – a consensual restructuring in anticipation of a possible governmental intervention which has the same effect, i.e. to write-down or exchange all of the relevant debt. This is what Anglo Irish Bank Corporation Limited (**Anglo Irish**) sought to achieve in an exchange offer by which the subordinated debt would in effect be pre-emptively written down before there was any government intervention. If accepted by bondholders, such exchange offer would leave no subordinated debt outstanding. Anglo Irish had three series of subordinated bonds outstanding²⁶ and effected their restructuring in two stages. First, there was an exchange offer on its 2017 bonds, which led to a Restructuring Credit Event at a time when the two other series of subordinated bonds were still outstanding. Subsequently, the two further series of subordinated bonds were restructured by way of a similar exchange offer only after the Auctions for the first Restructuring Credit Event had settled. Anglo Irish had to effect this two stage restructuring in order to ensure that there were sufficient Deliverable Obligations for the Auction.²⁷ This would not have been possible if there been only one series of subordinated bonds outstanding in the first place, which is where the benefit of Asset Package Delivery comes in. However, if the new Asset Package Delivery provisions were restricted to Governmental Intervention of a Financial Reference Entity, Asset Package Delivery would not be available in an Anglo Irish situation because there has been no governmental intervention. This has been addressed by extending the Asset Package Delivery provisions to CDS under which a Restructuring Credit Event occurs in respect of the Reference Obligation of a Financial Reference Entity in circumstances where such Restructuring does not constitute a Governmental Intervention, but limiting the Prior Deliverable Obligation to the Reference Obligation.²⁸ The reason for limiting Asset Package Delivery in this scenario to the Reference Obligation only is to reduce the moral hazard risk described above whereby bondholders with CDS protection may be incentivised differently to bondholders with no CDS protection. Where the Credit Event is a Governmental Intervention, such moral hazard is not a concern as the terms of the bail-in are imposed by a governmental authority or regulator with limited negotiation/discussion with bondholders as to what they would be prepared to accept as part of a debt

Asset Package Delivery:

- > Asset Package Delivery will also apply where:
 - (i) Financial Reference Entity Terms are specified in the confirmation for the CDS; and
 - (ii) a Restructuring Credit Event occurs in respect of the Reference Obligation of a Financial Reference Entity where such Restructuring does not constitute a Governmental Intervention,
 - (iii) in which case the Asset Package which is deliverable is that which results from the Reference Obligation.

²⁶ One maturing in 2014, one in 2016 and one in 2017.

²⁷ This two stage restructuring was also used effectively with the Irish Life and Permanent PLC restructuring.

²⁸ Sections 3.3(b) and 8.9(a)(ii) of the 2014 Definitions.

exchange. On a Restructuring instigated by the Reference Entity, these types of negotiation are quite likely to take place, but the Reference Obligation will generally be widely enough held that, in practice, it would be difficult for any individual bondholders to negotiate/agree a 'poor' deal for the purposes of their CDS.

Successor Provisions

4. Universal Successor

Background: Under the 2003 Definitions a look-back period applies to all Succession Events meaning that a Successor to a Reference Entity can only be determined if notified (to the Determinations Committee or to the other party under the CDS) within 90 days of the relevant Succession Event. There have been instances of succession events going unnoticed and therefore no longer applying to enable the protection under a CDS to follow the appropriate Successor but the catalyst for change came with the Unitymedia GmbH (**Unitymedia**) Succession Event. Unitymedia underwent a universal succession whereby all its obligations were assumed by a different entity and the existing entity was dissolved. The new entity changed its name to Unitymedia and hence it was some considerable time, and well past the 90 day look-back period, before the market became aware that the old Unitymedia no longer existed.²⁹ Consequently, certain CDS referencing Unitymedia were effectively 'orphaned' (as they were no longer able to determine a Successor due to the expiry of the 90 day look-back period) and were therefore worthless.

New definition of Universal Successor: The 2014 Definitions introduce a new definition of a Universal Successor (i.e. an entity which assumes all obligations (including at least one Relevant Obligation) of a non-Sovereign Reference Entity in circumstances where the Reference Entity has ceased to exist or is in the process of being dissolved)³⁰ and applies a single fixed backstop date of 1 January 2014.³¹ This is a limited exception to the 90 day look-back period and only applies to a Universal Successor and not any other Successor determination.

5. Steps Plan

Background: The provisions setting out the determination of a Successor to a Reference Entity under the 2003 Definitions require the occurrence of a Succession Event (i.e. the occurrence of some identifiable corporate event triggering the transfer of obligations). Where an entity instigates a debt transfer in stages, none of which individually cross the relevant thresholds for the transfer of obligations provided in the 2003 Definitions, the determination of a Successor can be problematic.

²⁹ In September 2010 Unitymedia GmbH merged with and into UPC Germany GmbH. UPC Germany GmbH survived the merger but, on the same date as the merger, UPC Germany GmbH, changed its name to Unitymedia GmbH.

³⁰ Section 2.2(a)(vii) of the 2014 Definitions. In addition the Reference Entity must not have issued or incurred any Borrowed Money obligation at any time following the legally effective date of the assumption.

³¹ Section 2.2(c)(i). For an entity to be a Universal Successor the relevant Succession Date must occur on or after 1 January 2014.

Universal Successor:

- > The 2014 Definitions introduce a new definition of a Universal Successor for an entity which assumes all obligations of a non-Sovereign Reference Entity in circumstances where the Reference Entity no longer exists or is in the process of being dissolved.
- > The 90 day look-back period does not apply in the case of a Universal Successor. Instead, there is a single backstop date of 1 January 2014.

Steps Plans:

- > The 2014 Definitions do not include the concept of a Succession Event for corporates.
- > New provisions are included to address a series of successions to some or all of the relevant obligations of the Reference Entity by one or more entities as part of a pre-determined transfer plan (a **Steps Plan**).

Introduction of Steps Plan: The answer has been to remove the concept of a Succession Event entirely from the 2014 Definitions and to introduce a new concept of a **Steps Plan** which aggregates all individual transfers of debt which take place as part of a pre-determined transfer plan when determining whether or not sufficient debt has been transferred to enable a Successor to be determined.³² The 2014 Definitions also include a new definition of **Succession Date** which, for the purposes of a Steps Plan, will generally be the effective date of the final transfer pursuant to such Steps Plan.³³

6. Standard Reference Obligation

Background: There has been increasing focus on, and desire for, further standardisation in the credit derivatives market from both regulators and market participants, particularly in connection with the clearing of CDS.

New Standard Reference Obligation provisions: Standardisation of the CDS market continues with the introduction of the Standard Reference Obligation provisions which will apply for the more commonly traded Reference Entities.³⁴ For these Reference Entities, parties will no longer need to specify a Reference Obligation for their CDS; the Reference Obligation will be the obligation specified as the Standard Reference Obligation for the relevant Reference Entity for the relevant Seniority Level on a list to be published by ISDA.³⁵ The rules for determining the Standard Reference Obligation, and for determining the Substitute Reference Obligation for a Standard Reference Obligation, in respect of a particular Reference Entity at any time have not yet been published but will be set out in the DC Rules.

This level of standardisation will be useful even for non-standard CDS, for example cash settled CDS which use the Final Price of the Reference Obligation to settle the contract. All other terms being equal, having a market standard Reference Obligation ensures back-to-back CDS will be valuing the same Reference Obligation for the purposes of settling their CDS and will minimise basis risk where parties have hedged by way of a CDS referencing the Standard Reference Obligation. However, parties will be able to disapply the Standard Reference Obligations in the confirmation for a particular CDS if so desired and specify an alternative Reference Obligation (a **Non-Standard Reference Obligation**).

Standard Reference Obligation:

- > Unless expressly disappplied in the confirmation for a CDS, under the 2014 Definitions the Reference Obligation will be the Standard Reference Obligation for the relevant Reference Entity for the relevant Seniority Level published by ISDA.
- > Parties can elect to disapply the Standard Reference and specify an alternative Non-Standard Reference Obligation.

³² Sections 2.2(i), 2.2(j), 2.2(b) and 2.2(f) of the 2014 Definitions.

³³ Section 2.2(j) of the 2014 Definitions.

³⁴ Sections 2.5 and 2.6 of the 2014 Definitions.

³⁵ Sections 2.6, 2.17 and 2.18 of the 2014 Definitions. The **SRO List** as defined in Section 2.18 of the 2014 Definitions. The relevant Seniority Level for an obligation of the Reference Entity will be as specified in the confirmation, or if not specified the same level as seniority as the original non-Standard Reference Entity, failing which Senior Level.

7. Substitute Reference Obligation

Background: In connection with the introduction of the Standard Reference Obligation provisions changes have been made in the 2014 Definitions to the provisions for identifying a substitute obligation for a non-Standard Reference Obligation.³⁶

Revisions to Substitute Reference Obligation provisions: Where a CDS has a Non-Standard Reference Obligation and a Substitution Event occurs in relation to the Reference Obligation, parties will be subject to the revised provisions for identifying a substitute Reference Obligation set out in the 2014 Definitions. The 2014 Definitions include a new definition of **Substitution Event** which not only includes the redemption in whole of the relevant Non-Standard Reference Obligation; but is also triggered by: (i) a reduction by redemption or otherwise in the aggregate amounts due under the Non-Standard Reference Obligation to below USD 10,000,000 (or its equivalent in the relevant Obligation Currency, as determined by the Calculation Agent); or (ii) the Non Standard Reference Obligation ceasing to be an obligation of the relevant Reference Entity (either directly or as provider of a guarantee) for any reason, other than due to the existence or occurrence of a Credit Event.

Under the 2014 Definitions, the Substitute Reference Obligation must satisfy a number of criteria including the requirement that, where the original Non-Standard Reference Obligation satisfied the Deliverable Obligation Category and Characteristics when issued (and immediately prior to the date of the relevant Substitution Event), the Substitute Reference Obligation must also satisfy such Deliverable Obligation Category and Characteristics.³⁷ This represents a different position than under the 2003 Definitions, where, even if the original Reference Obligation was a Deliverable Obligation, it is possible for a substitute obligation to constitute a Substitute Reference Obligation even if it does not satisfy the Deliverable Obligation Characteristics as the 2003 Definitions require only that the replacement obligation be an Obligation of the Reference Entity that ranks *pari passu* to the original obligation and is 'economically equivalent'.³⁸ Under the 2014 Definitions, this 'economically equivalent' approach would no longer be possible if the obligation did not otherwise meet the Deliverable Obligation Characteristics.

The 2014 Definitions also provide a specified order for determining the most suitable Substitute Reference Obligation.³⁹

Substitute Reference Obligation provisions for Non-Standard Reference Obligations:

- > Under the 2014 Definitions, if a Substitution Event occurs in respect of a Non-Standard Reference Obligation, such obligation satisfied the Deliverable Obligation Category and Characteristics when issued and immediately prior to the date of the relevant Substitution Event, any substitute Reference Obligation must also satisfy such Deliverable Obligation Category and Characteristics.
- > Each of the following will constitute a Substitution Event:
 - (i) redemption in whole of the Non-Standard Reference Obligation;
 - (ii) a reduction (whether by redemption or otherwise) in the aggregate amounts due under the Non-Standard Reference Obligation to below USD 10,000,000 (or its equivalent in the relevant Obligation Currency); and
 - (iii) the Non Standard Reference Obligation ceasing to be an obligation of the relevant Reference Entity (either directly or as provider of a guarantee) for any reason, other than due to the existence or occurrence of a Credit Event.

³⁶ Substitute Reference Obligations for Standard Reference Obligations will be determined pursuant to the DC Rules and published by ISDA.

³⁷ Section 2.10 of the 2014 Definitions.

³⁸ This was the case with the recent Substitute Reference Obligation determination for Assicurazioni Generali S.p.A. (**Generali**) where, as a result of market practice changes to address Solvency II, all subordinated obligations of Generali included write-down provisions which meant they did not satisfy the 'Not Contingent' Deliverable Obligation Characteristic. The Determinations Committee was nevertheless able to identify a substitute obligation which was 'economically equivalent' to the redeemed Reference Obligation.

³⁹ Section 10(c) of the 2014 Definitions.

8. Sovereign Succession Event

Background: The 2003 Definitions contain minimal guidance for determining a Successor for Sovereign Reference Entities, providing simply that a Successor is each entity which becomes a direct or indirect successor to the Reference Entity by way of Succession Event.⁴⁰

Sovereign Successors: The 2014 Definitions retain the concept of a Succession Event for Sovereigns (which now becomes a **Sovereign Succession Event**⁴¹) and have aligned the methodology for determining a Successor to the approach applied to corporate Reference Entities, such that a CDS referencing a Sovereign Reference Entity in relation to which a Sovereign Succession Event occurs will follow the entity/entities to which the debt is transferred, depending on the percentage of the debt transferred.⁴²

Restructuring

9. Restructuring Credit Event

Background: The Restructuring Credit Event has been heavily relied on in recent years but has given rise to some difficult interpretational questions: does a bond exchange trigger a Restructuring when technically there is a new obligation rather than a restructured obligation? does a redenomination constitute a Restructuring where the new currency subsequently depreciates such that the obligation is worth less?

Amendments to Restructuring: The result has been some revisions to the definition of Restructuring in the 2014 Definitions which are (depending on your interpretation of the current definition of Restructuring in the 2003 Definitions) either clarifications or changes to the circumstances in which a Restructuring can occur.⁴³ The amendments which have been made are as follows:

- > If there is a bond exchange affecting all of a series of bonds, the Restructuring Credit Event will still apply and the terms of the new bond will be compared to the terms of the old bond to see if a Restructuring Credit Event has occurred.⁴⁴
- > A write-down of interest or principal can occur by way of redenomination.
- > A redenomination out of euros will not be a Restructuring if: (i) it occurs as a result of the action of a Governmental Authority of an EU Member

Sovereign Succession Event:

- > Successor provisions for Sovereign Reference Entities and non-Sovereign Reference Entities have been aligned.
- > A Sovereign CDS will follow the debt of the original Reference Entity in the same way as for a corporate Successor determination.

Restructuring Credit Event:

- > A number of changes have been made to the definition of Restructuring in the 2014 Definitions.
- > A bond exchange can constitute a restructuring if, on comparison of the terms of the new bond to the old bond, one of the events in the definition of Restructuring has occurred.
- > A redenomination which all constitutes a reduction in principal or interest will be a Restructuring Credit Event.

⁴⁰ Section 2.2(h) of the 2003 Definitions.

⁴¹ Sections 2.2(c)(iii) and 2.2(e) of the 2014 Definitions. This covers an annexation, unification, secession, partition, dissolution, consolidation, reconstitution or other similar event in respect of a Sovereign Reference Entity.

⁴² Section 2.2 of the 2014 Definitions.

⁴³ Section 4.7 of the 2014 Definitions.

⁴⁴ Section 4.7(d) of the 2014 Definitions. That is, you look at the new bond to determine whether one of the events set out in limb (a) of the definition of the Restructuring Credit Event has occurred. Previously, if the old bonds remained outstanding after the bond exchange (i.e. the issuer did not cancel the bonds) then no Restructuring Credit Event would occur. Note that the 2014 Definitions refer only to a 'Bond' exchange rather than an 'Obligation' exchange, which was the approach used in the 1999 Credit Derivatives Definitions under the definition 'Obligation Exchange'.

State; (ii) there was a freely available market rate of conversion between euros and the other currency at the time of such redenomination; and (iii) there is no a write-down of interest, principal or premium (determined by reference to the rate of conversion at the time).⁴⁵

- > There is no requirement for a deterioration in creditworthiness where the redenomination out of euros is as a result of action by a Governmental Authority of an EU Member State generally in the relevant jurisdiction.
- > A redenomination imposed by a Governmental Authority which does not itself constitute a reduction in principal, premium or interest (as determined by reference to the freely available market rate of conversion at the time of redenomination) will not subsequently be a Failure to Pay Credit Event if that new currency depreciates against the old currency.⁴⁶

10. Old Restructuring, Modified Restructuring and Modified Modified Restructuring

Background: The amendments to the 2003 Definitions made by the July 2009 Supplement, combined with accompanying revisions to the DC Rules, made it possible to hold one or more Auctions to settle CDS following a Restructuring. However, the provisions are complex and ISDA has therefore taken the opportunity to review how these provisions have worked in practice and make a number of simplifications.

Restructuring Provisions Revised: The Modified Restructuring (**Mod R**) and Modified Modified Restructuring (**Mod Mod R**) provisions (now jointly referred to as an **M(M)R Restructuring**) have undergone some revisions which will simplify the auction process and remove some of the complexity in working with these provisions.⁴⁷

One of the key changes is the removal of the Enabling Obligation. Under the pre 'Small Bang' 2003 Definitions, if Mod R or Mod Mod R applied and the Buyer delivered the Credit Event Notice then they could only deliver Deliverable Obligations with a maturity up to the Scheduled Termination Date

Old R, Mod R and Mod Mod R

- > Old R no longer requires delivery of a Credit Event Notice following a DC Credit Event Announcement.
- > When determining the maturity date of the Deliverable Obligations for a Mod R and Mod Mod R there is no longer a requirement for an Enabling Obligation; a CDS now will apply the Auction Final Price for the Auction where its Scheduled Termination Date falls into the relevant date range for such Auction.
- > For Mod Mod R a Restructured Bond or Loan will now be delivered into the maturity 'bucket' into which its pre-Restructuring maturity date fell (or into which its restructured maturity date falls, if earlier), provided that it matures prior to the 10 year Limitation Date.
- > The number of maturity 'buckets' (and therefore the maximum number of Auctions) for Mod Mod R has been reduced.

⁴⁵ Otherwise, a redenomination into a currency other than the lawful currency of Canada, Japan, Switzerland, the UK, the US or the euro will be a Restructuring under Section 4.7(a)(v) of 2014 Definitions.

⁴⁶ Section 4.11 of the 2014 Definitions. A freely available market rate of conversion must exist at the time of the redenomination. These provisions clarify the so-called Bradford & Bingley principle whereby, pursuant to Section 4.1(c) of the 2003/2014 Definitions, if an event occurs as a result of a change in law then such event will still constitute a Credit Event notwithstanding that it is imposed by a change in law. With Bradford & Bingley, a Failure to Pay Credit Event occurred on 30 July 2009 (following the expiry of a 14 day grace period) as the UK Treasury Order that came into force on 20 February 2009 prevented amounts under subordinated obligations from becoming due until the Financial Services Compensation Scheme was paid off in full. As this non-payment was imposed by a statutory instrument (i.e. by a change in law), Section 4.1(c) of the 2003 Definitions applied to ensure that it still constituted a Failure to Pay Credit Event.

⁴⁷ Sections 3.31, 3.32 and 3.33 of the 2014 Definitions. The references within the definitions to 'Mod R' and 'Mod Mod R' which can now be specified in the confirmation for a CDS are a helpful clarification.

of the CDS⁴⁸. With the introduction of Auction Settlement for Restructuring Credit Events ('Small Bang'), CDS were allocated to maturity 'buckets' that could result in the delivery of Deliverable Obligations that matured after the Scheduled Termination Date. There was some concern about the perceived 'windfall' that Buyers would get in these circumstances (i.e. that they could be in a better position than they would have been pre 'Small Bang'), so the Enabling Obligation concept was introduced to ensure that a CDS would only be allocated to the maturity 'bucket' in which its Scheduled Termination Date fell if there was at least one Deliverable Obligation in the maturity range for that 'bucket' that matured on or prior to such Scheduled Termination Date, failing which the 'rounding down convention' would result in that CDS being moved to a shorter-dated maturity 'bucket'. If there was an Enabling Obligation, then this still potentially resulted in more Deliverable Obligations being deliverable than there would have been pre-'Small Bang', namely those maturing after the Scheduled Termination Date but on or prior to the next Limitation Date, but this was seen as an acceptable compromise. However, the Enabling Obligation requirement ultimately proved too complicated for the purpose it served and has consequently been removed. The result, under the 2014 Definitions, is that the Buyer potentially has an even greater range of Deliverable Obligations to deliver than under the 2003 Definitions.

Additional changes have been made to Mod Mod R, including a reduction in the number of Limitation Dates for the purposes of the Modified Restructuring Maturity Limitation Date (which results in a consequent reduction in the maximum number of Auctions that will be run for a Mod Mod R)⁴⁹ and provisions relating to which Auction a Restructured Bond or Loan is delivered into. Under the 2014 Definitions, a Restructured Bond or Loan maturing prior to the 10-year Limitation Date will now be delivered into the maturity 'bucket' into which its pre-Restructuring maturity date falls (or into which it restructured maturity date falls, if earlier).⁵⁰

Old R: Old Restructuring (**Old R**) has also had an update. The 2003 Definitions provide optionality for the parties to trigger any Restructuring Credit Event by delivering a Credit Event Notice. However, in general maturity limitation restrictions only apply to a CDS where: (i) Restructuring is a Credit Event and Mod R or Mod Mod R apply; and (ii) it is the Buyer that delivers the relevant Credit Event Notice. Consequently, the Deliverable Obligations under a CDS to which Mod R or Mod Mod R apply may differ depending on whether the Buyer or the Seller is the triggering party. It is therefore understandable that the parties are given the optionality of deciding whether to trigger the CDS. As no maturity limitation restrictions apply to Old R and there is no difference in the Deliverable Obligations depending on the identity of triggering party, there is no need to retain such optionality for Old R. For this reason, ISDA has decided to turn Old R into an automatically triggered

⁴⁸ if the Seller delivered the Credit Event Notice then this maturity restriction did not apply and there were some relaxations for a Restructured Bond or Loan, but these concepts have been retained so are not discussed here.

⁴⁹ Pursuant to Section 3.32(d) of the 2014 Definitions CDS with a Scheduled Termination Date falling after the 10-year Limitation Date will have a Modified Restructuring Maturity Limitation Date equal to such Scheduled Termination Date.

⁵⁰ Section 3.31(a) of the 2014 Definitions.

Credit Event which will apply automatically to parties' CDS following an Old R Credit Event Announcement by the relevant Determinations Committee.⁵¹

Terms relating to Obligations and Deliverable Obligations

11. Outstanding Principal Balance

Background: Outstanding principal balance is an important term in the settlement provisions of the 2003 Definitions; the Deliverable Obligation delivered under a CDS or into an Auction will have an outstanding principal balance that is equal to the notional of the CDS⁵² and for the purposes of Auction Settlement, the Auction Final Price is expressed as a percentage of the outstanding principal balance of the relevant Deliverable Obligation. The concept is also used in the context of Succession Events and obtaining quotes for Obligations. However, the 2003 Definitions do not define outstanding principal balance but do include provisions for determine the outstanding principal amount of Accreting Obligations, Exchangeable Obligations and Convertible Obligations. The difficulty with these provisions is that, while detailed, they exclude certain obligations which do not fall squarely within these provisions, which can lead to uncertainty as to what the outstanding balance should be in certain circumstances. It is also not entirely clear how the contingent element of a relevant Obligation should be treated.⁵³

New definition of Outstanding Principal Balance: The 2014 Definitions introduce a new definition of Outstanding Principal Balance and make two further key changes.⁵⁴ The first is that the Not Contingent Deliverable Obligation Characteristic has been removed. This concept is now encapsulated within the definition of Outstanding Principal Balance such that the Outstanding Principal Balance of an obligation will not include any amount subject to a contingency other than certain Permitted Contingencies. Such Permitted Contingencies include certain provisions relating to transfer, implementation of subordination, Permitted Transfers of Qualifying Guarantees (or release of other Guarantees), Solvency Capital Provisions and Governmental Intervention.⁵⁵

The second is that the provisions in the 2003 Definitions relating to Accreting Obligations, Exchangeable Obligations and Convertible Obligations have been deleted entirely and addressed through a much simpler provision which asks what would the claim of the holder be if the obligation was accelerated

Outstanding Principal Balance:

- > The 2014 Definitions now define Outstanding Principal Balance.
- > The Outstanding Principal Balance of a Deliverable Obligation is determined by a clear three-step process which asks:
 - (i) what is the principal due;
 - (ii) what amount of that is non-contingent; and
 - (iii) if such non-contingent amount was payable today, what is the claim in respect thereof?
- > Permitted Contingencies (when determining the Outstanding Principal Balance) include Solvency Capital Provisions and provisions anticipating a Governmental Intervention.
- > The 'Not Contingent' Deliverable Obligation Characteristic has been removed from the 2014 Definitions.

⁵¹ Sections 1.16 and 14 refer only to M(M)R Restructurings.

⁵² Section 8.1 of the 2003 Definitions. It is possible to deliver an Outstanding Principal Balance not exactly equal to the CDS notional, but that will affect the amount the Seller pays to the Buyer.

⁵³ Notwithstanding this observation, Determinations Committees have consistently resolved that bonds with call options to redeem at less than par should be treated as having an Outstanding Principal Balance equal to the call price.

⁵⁴ Section 3.8 of the 2014 Definitions.

⁵⁵ Section 3.11 of the 2014 Definitions. 'Solvency Capital Provisions' are defined in Section 3.19 of the 2014 Definitions to cover terms in an obligation permitting the deferral, suspension, cancellation, conversion, reduction or other variation to the payment obligations of the Reference Entity and which are necessary in order for the obligation to constitute capital resources for a particular tier. See paragraph 12 below for further information on Permitted Transfers.

at a particular point in time. This concept is referred to in the 2014 Definitions as the **Quantum of the Claim**.

12. Qualifying Guarantee

Background: Qualifying Guarantee is a key definition which determines whether a guarantee of the Reference Entity will be a 'good' Obligation (which can therefore trigger a Credit Event) and a 'good' Deliverable Obligation for the purposes of settling CDS.⁵⁷ However, it is a highly technical definition and has resulted in guarantees failing to qualify on technicalities even though market expectation was that such guarantee was an Obligation/Deliverable Obligation of the relevant Reference Entity. One particular limb of the definition which has produced such a result is the requirement that a Qualifying Guarantee cannot be released in any circumstances other than payment, so a provision entitling the guarantee to be transferred in the context of a merger (for example) could result in the guarantee failing to be a Qualifying Guarantee.⁵⁸ This is the case even if the relevant release provision has effectively been 'switched-off' as a result of certain events and is therefore no longer operative. This scenario arose following the eircom Limited (**eircom**) Credit Event in 2012 and resulted in CDS on eircom being orphaned (i.e. there were no Deliverable Obligations for settlement of the CDS) as a result of the guarantee provided by eircom failing the definition of Qualifying Guarantee on the grounds described above.

Another problem that commonly arises is the existence of a cap in the guarantee. Under the 2003 Definitions a Qualifying Guarantee needs to provide a guarantee of 'all amounts' under the Underlying Obligation⁵⁹ so any cap on the amount payable under the guarantee prevents it being a Qualifying Guarantee, regardless of the level of the cap.

Amendments to the definition of Qualifying Guarantee: Several amendments have been made to the definition of Qualifying Guarantee in the 2014 Definitions.⁶⁰

The requirements for a Qualifying Guarantee have changed from having to guarantee '*all amounts due under an obligation*' to '*all amounts of principal and interest ... due under an Underlying Obligation*'. This should result in fewer guarantees failing to qualify on the technicality that there are amounts payable under the Underlying Obligation which are not covered by the guarantee, such as possibly the existence of a make-whole amount in the relevant Underlying Obligation which is not guaranteed.

Certain exceptions to the prohibition on a release clause in the guarantee have been permitted. These exceptions include a Permitted Transfer (i.e. a transfer of the guarantee coupled with a transfer of substantially all of the assets of the Reference Entity to the same transferee). The definition also

Qualifying Guarantees:

- > A guarantee containing any of the following provisions will now qualify as a Qualifying Guarantee:
 - (i) a Fixed Cap;
 - (ii) a provision providing for a Permitted Transfer of the guarantee;
 - (iii) provisions providing for a release as a result of a Governmental Intervention (if the Reference Entity is a Financial Reference Entity);
 - (iv) Solvency Capital Provisions which anticipate a release from payment to meet Solvency II requirements; and/or
 - (v) a release provision which has been 'switched-off' by the occurrence of a bankruptcy or failure to pay by the Underlying Obligor.
- > Statutory guarantees are expressly included within the definition of Qualifying Guarantee.⁵⁶

⁵⁶ We note that that the 2014 Definitions do not clarify whether the 'irrevocable' requirement would or would not apply to them so there is still some uncertainty on this point.

⁵⁷ Sections 2.14, 2.15, 2.21(d) and 2.23 of the 2003 Definitions.

⁵⁸ Section 2.23 of the 2003 Definitions.

⁵⁹ Section 2.23 of the 2003 Definitions.

⁶⁰ Section 3.21 of the 2014 Definitions.

addresses 'switch-off' provisions so that a release clause which has been switched-off by the occurrence of a bankruptcy or failure to pay by the Underlying Obligor and therefore is no longer capable of taking effect will be ignored when assessing whether the guarantee is a Qualifying Guarantee.

The 2014 Definitions also include a new concept of a **Fixed Cap** which in effect permits a specified numerical cap on the liability of the Reference Entity under the guarantee in respect of some/all payments due under the Underlying Obligation, provided that only the amount of the cap can be taken into account in determining the Outstanding Principal Balance of the guarantee for the purposes of delivery as a Deliverable Obligation.⁶¹ Also expressly permitted are provisions anticipating a Governmental Intervention (a mandatory bail-in of a bank – see paragraph 1 above) or allowing write-down or release for Solvency II purposes, both of which previously resulted in a guarantee failing to meet the definition of Qualifying Guarantee under the 2003 Definitions.

These are welcome changes which should result in more guarantees that the market views as 'good' obligations of a Reference Entity satisfying the definition of Qualifying Guarantee and so qualifying as an Obligation/Deliverable Obligation of the Reference Entity.

Other notable changes

13. Subordinated European Insurance Reference Entities

Parties may apply Subordinated European Insurance Terms to their CDS such that if the subordinated debt contains provisions contemplating a deferral of maturity to comply with solvency requirements, those provisions will not result in the debt failing to meet the Maximum Maturity Deliverable Obligation Characteristic.⁶² Furthermore, the amount of principal subject to any such contingency will be a Permitted Contingency and hence still taken into account in determining the Outstanding Principal Balance of a Deliverable Obligation.⁶³

14. Event Determination Date

The definition which everyone loves to hate has been split out into two separate provisions: one dealing with market standard trades which provide for Auction Settlement to apply and for both parties to the trade to be a Notifying Party (**Event Determination Date**), and the other for all other trades (**Non-Standard Event Determination Date**).⁶⁴ Transactions falling under the Event Determination Date provision will now be automatically triggered by the occurrence of a DC Credit Event Announcement.⁶⁵ There have been some

⁶¹ Section 3.26 of the 2014 Definitions. The limit/cap must be a specified numerical limit/cap and may not be determined by reference to a formula or variable inputs.

⁶² Section 3.15(h) of the 2014 Definitions.

⁶³ Sections 3.11(a)(iv), 3.15(h) and 3.21(b)(v)(B) of the 2014 Definitions.

⁶⁴ Sections 1.16 and 14.1 of the 2014 Definitions.

⁶⁵ Sections 1.16(a) of the 2014 Definitions. Additional considerations apply where the relevant Credit Event is an M(M)R Restructuring. As under the 2003 Definitions, in certain circumstances the Event Determination Date may be the Notice Delivery Date (i.e. the date on which an effective Credit Event Notice and, where applicable, Notice of Publicly Available Information, are delivered).

minor tweaks to the provisions in the process. This is largely an aesthetic rather than a substantive change but one that should facilitate ease of use of this complicated provision.

15. Conditions to Settlement

A consequence of the changes made to the definition of Event Determination Date, including dealing with the requirement to deliver a Notice of Publicly Available Information in that definition, is that the Conditions to Settlement are no longer required. The occurrence of an Event Determination Date (together with delivery of an effective Notice of Physical Settlement, where applicable) is now the only precondition to settlement of a CDS.⁶⁶

16. Deliverable Obligation Characteristics for Loans

The Not Domestic Issuance Deliverable Obligation Characteristic no longer applies to Loans.⁶⁷

17. Escrow and Novation Provisions

All of these provisions have been removed entirely, shortening the 2014 Definitions by several pages.

What happens now?

- > **Implementation:** The 2014 Definitions will be used for new CDS transactions from the roll date for iTraxx and CDX transactions in September 2014. It is anticipated that certain changes will also be the subject of an ISDA Protocol allowing parties to amend their existing CDS transactions to incorporate those changes (the **2014 Definitions ISDA Protocol**).
- > **DC Rules and supporting documentation:** The DC Rules will also need updating (in particular to include the provisions for the 'Standard Reference Obligation' and the 'Substitute Reference Obligation' for a Standard Reference Obligation), as will the ISDA Credit Derivatives Physical Settlement Matrix and template CDS confirmations to include the new Credit Event of Governmental Intervention and Financial Reference Entity Terms and Subordinated European Insurance Terms.
- > **Market Bifurcation:** There is expected to be a bifurcated market from September onwards with CDS transactions on both the 2003 Definitions (**Old Transactions**) and CDS transactions on the 2014 Definitions (**New Transactions**) referencing the same Reference Entity, with obvious basis risk implications if parties have an outstanding transaction on the 2003 Definitions which is hedged by a transaction on the 2014 Definitions. It is not yet clear whether Auction Settlement Terms post-September 2014 will apply to all CDS transactions on that Reference Entity, only New Transactions and protocol covered CDS transactions, or just New Transactions. As a result of amendments to the Deliverable Obligation provisions, there

⁶⁶ The requirement to deliver a Notice of Publicly Available Information has been consolidated into the revised definition of Event Determination Date.

⁶⁷ Sections 3.15(a) and (b) of the 2014 Definitions.

may be Deliverable Obligations under New Transactions which will not satisfy the requirements for Deliverable Obligations under Old Transactions: this is particularly likely to be the case following a Mod R or Mod Mod R Credit Event as a result of the removal of the Enabling Obligation requirement in the 2014 Definitions.

Points to consider

- > Firms will need to review and update their template documentation and operational systems in anticipation of the 2014 Definitions going live in September 2014.
- > Firms will need to identify existing transactions (and transactions which are to be entered into between now and September 2014) which are or are not to be subjected to the 2014 Definitions ISDA Protocol.
- > Issuers and arrangers of credit linked notes (**CLNs**) should consider the impact of the 2014 Definitions on the terms, availability and cost of hedging transactions for both CLNs outstanding in September 2014 and new issuances. Hedging transactions for existing and fungible issues which need to be under the 2003 Definitions may be more expensive and the availability of such transactions may be limited.
- > Issuers and arrangers of CLN programmes, the terms of which are based on the 2003 Definitions, should consider when and how to amend their programmes for the 2014 Definitions. Where CLNs are issued under a programme based on the 2003 Definitions but the related hedge is a market standard hedge on the 2014 Definitions, basis risk will arise.

Linklaters

Contacts

For further information please contact:

Paul Lewis
Partner, London

(+44) 20 7456 4658
paul.lewis@linklaters.com

Chin-Chong Liew
Partner, Hong Kong

(+852) 2842 4857
chin-chong.liew@linklaters.com

Caird Forbes-Cockell
Partner, New York

(+1) 212 903 9040
caird.forbes-cockell@linklaters.com

Mark Brown
Partner, London

(+44) 20 7456 5229
mark.brown@linklaters.com

Victor Wan
Partner, Hong Kong

(+852) 2901 5338
victor.wan@linklaters.com

Mark Middleton
Partner, New York

(+1) 212903 9232
mark.middleton@linklaters.com

Deepak Sitlani
Partner, London

(+44) 20 7456 2616
deepak.sitlani@linklaters.com

Andrew Malcom
Partner, Hong Kong

(+852) 2842 4803
andrew.malcom@linklaters.com

Andrei Murygin
Partner, Moscow

(+7) 495797 9740
andrei.murygin@linklaters.com

David Phillips
Partner, London

(+44) 20 7456 5215
david.phillips@linklaters.com

Akihiro Wani
Partner, Tokyo

(+81) 36212 1247
akihiro.wani@linklaters.com

Christian Storck
Partner, Frankfurt

(+49) 6971003 531
christian.storck@linklaters.com

Simon McKnight
Counsel, London

(+44) 20 7456 3316
simon.mcknight@linklaters.com

Motoyasu Fujita
Counsel, Tokyo

(+81) 36212 1213
motoyasu.fujita@linklaters.com

Jörg Fried
Counsel, Berlin

(+49) 3021496 331
joerg.fried@linklaters.com

Suzanna Brunton
Managing Associate, London

(+44) 20 7456 5382
suzanna.brunton@linklaters.com

Kenneth Lam*
Managing Associate, Tokyo

(+81) 36212 1437
kenneth.lam@linklaters.com

Paloma Fierro
Partner, Madrid

(+34) 91399 6054
paloma.fierro@linklaters.com

Lala Phillips
Senior PSL, London

(+44) 20 7456 5790
lala.phillips@linklaters.com

Henry Lobb
Managing Associate, Singapore

(+65) 6692 5850
henry.lobb@linklaters.com

Cibele Natasha Antunes
Counsel, Paris

(+33) 15643 2813
cibele_natasha.antunes@linklaters.com

Authors: Suzanna Brunton, Simon McKnight and Lala Phillips

A17717356

This publication is intended merely to highlight issues and not to be comprehensive, nor to provide legal advice. Should you have any questions on issues reported here or on other areas of law, please contact one of your regular contacts, or contact the editors.

© Linklaters LLP. All Rights reserved 2014

Linklaters LLP is a limited liability partnership registered in England and Wales with registered number OC326345. It is a law firm authorised and regulated by the Solicitors Regulation Authority. The term partner in relation to Linklaters LLP is used to refer to a member of Linklaters LLP or an employee or consultant of Linklaters LLP or any of its affiliated firms or entities with equivalent standing and qualifications. A list of the names of the members of Linklaters LLP together with a list of those non-members who are designated as partners and their professional qualifications is open to inspection at its registered office, One Silk Street, London EC2Y 8HQ or on www.linklaters.com and such persons are either solicitors, registered foreign lawyers or European lawyers.

Please refer to www.linklaters.com/regulation for important information on our regulatory position.

We currently hold your contact details, which we use to send you newsletters such as this and for other marketing and business communications.

We use your contact details for our own internal purposes only. This information is available to our offices worldwide and to those of our associated firms.

If any of your details are incorrect or have recently changed, or if you no longer wish to receive this newsletter or other marketing communications, please let us know by emailing us at marketing.database@linklaters.com.

*Bengoshi and Gaikokuho Jimu Bengoshi are regulated by the Japan Federation of Bar Associations and the relevant local bar associations. Lawyers who are based in Linklaters Tokyo and qualified in other jurisdictions are also subject to regulation by the relevant regulatory body in their place of admission. Unregistered foreign lawyers who are based in Linklaters Tokyo work under the supervision of Gaikokuho Jimu Bengoshi/Bengoshi partners within the scope of "provision of services to Gaikokuho Jimu Bengoshi/Bengoshi" permitted under the relevant laws and regulations.