Linklaters

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2011 ISDA EQUITY DERIVATIVES DEFINITIONS

The International Swaps and Derivatives Association, Inc. (**ISDA**) has published the 2011 ISDA Equity Derivatives Definitions (**2011 Definitions**). The 2011 Definitions are available from the ISDA Bookstore.

The 2011 Definitions are more than a simple update of the 2002 ISDA Equity Derivatives Definitions (**2002 Definitions**). They introduce a new approach and architecture for the documentation of equity derivatives transactions.

The 2011 Definitions adopt an innovative, open, modular approach to the construction and documentation of equity derivatives transactions. Considerable additional functionality has also been added.

Linklaters acted as lead counsel to ISDA on the 2011 Definitions. This note and the FAQs provide an overview of the new architecture and approach of the 2011 Definitions as well as the key new and revised provisions.

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Background to the 2011 Definitions

In the aftermath of the financial crisis, global supervisors have focused on transforming and strengthening the OTC derivatives markets, working with the industry to improve and increase market transparency, standardisation and operational efficiency.

In line with industry commitments given to global supervisors, the 2011 Definitions have been designed to:

> consolidate the 2002 Definitions, Master Confirmation Agreements (**MCAs**), General Terms Confirmations (**GTCs**) and product annexes published by ISDA;

> facilitate further standardisation of legal terms;

> facilitate the adoption of transaction matrices;

> be machine readable;

> support increased electronic automation and standardisation of transaction processing to reduce confirmation backlogs and confirmation processing timelines; and

> facilitate electronic matching and transaction reporting.

The 2011 Definitions also include significant additional functionailty reflecting the growth in variety and complexity of equity derivatives products (e.g. dividend swaps and variance and volatility swaps and options) and the lessons learnt from market experiences in the last nine years.

A New Approach

The 2011 Definitions are:

> open in that they are neither product specific nor prescriptive; and

> modular in that they provide a menu of definitions and operative provisions that can be selected and combined to create different equity derivatives transactions.

To achieve this modularity, the 2002 Definitions, MCAs, GTCs, product annexes have been deconstructed into their core elements.

New Documentation Architecture

A new documentation architecture has been adopted for the 2011 Definitions. The 2011 Definitions are made up of a main book (**Main Book**) and an appendix to the Main Book (**Appendix**).

The Main Book sets out core definitions and operative provisions relevant to a wide variety of equity derivative transactions. The Appendix will contain tables setting out:

> different formulae and methodologies that may be selected and combined to create different payment and delivery obligations;

> different combinations of elections of Extraordinary Events to create different applications of risk allocation provisions;

> elections and methodologies for determining and identifying particular information (e.g. dates, a type of contract, a party, a formula etc.) relating to a defined term; and

> fallbacks for certain terms and elections if not specified in the confirmation.

The published Appendix is currently a template and gives an indication of the format, rather than the content, of the finished product. There will be a separate industry initiative to populate the Appendix with definitions, elections and methodologies (including new definitions that combine existing definitions and elections) that the industry agrees are required or should be available for particular equity derivative transactions. The Appendix will be amended, restated and republished on a more regular basis than the Main Book. It will also be used to add any new core definitions and operative provisions to the 2011 Definitions before they are consolidated into the Main Book.

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Equity derivative transactions will continue to be documented using a confirmation, but confirmations are intended to take the form of a short transaction supplement (**T-Supp**) incorporating by reference an ISDA published transaction matrix (**ISDA Transaction Matrix**). ISDA Transaction Matrices will be product/transaction specific and will identify (and, in some cases, complete) certain of the terms, elections, obligations, events and consequences drawn from the 2011 Definitions relevant to a particular product or transaction. Trade-specific data for a transaction, such as dates and amounts, will be set out in the T-Supp.

Transactions may also be documented under a long-form confirmation or other bilateral transaction agreement which may, if desired, incorporate and amend an existing ISDA Transaction Matrix.

“Confirmations are intended to take the form of a short transaction supplement incorporating by reference an ISDA published transaction matrix.”

Key Changes to Functionality and Risk Allocation

Key new concepts and drafting devices

> Introduction of Legs and a distinction between Equity Derivatives Legs documented using the 2011 Definitions and Non Equity Derivatives Legs documented under another set of ISDA Definitions (e.g. a floating leg documented using the 2006 ISDA Derivatives Definitions).

> Introduction of ED Leg Underliers and expansion of the types of equity underliers covered by the 2011 Definitions to include shares, depositary receipts, derivatives contracts, baskets, indices and the components and sub-components of baskets and indices.

> Introduction of ED Leg Reference Underlier to refer to the basket, derivatives contract, equity index, share, depositary receipt or other equity asset directly referenced by an ED Leg.

> Introduction of Specified, Applicable, Features, methodologies, toggles, prefixes and suffixes.

Key changes to functionality

> New framework and functionality for Days, Dates and Date Adjustment.

> Increased optionality and application of the modular approach to Times and Time Periods.

> Expansion of Exchanges to enable different types of exchanges to be specified as reference points for different purposes.

> New functionality for currency conversions and FX fixings.

> Application of the modular approach to Pricing and significant expansion of possible Pricing Elections.

> Extensive revision and expansion of electable Pricing Disruption Events (Market Disruption Events under the 2002 Definitions) and Pricing Disruption Event Consequences.

> Introduction of methodologies for Equity Notional Amount and other amounts.

> Revised framework for Options.

> Codification and upgrade of functionality in many MCAs, GTCs and product annexes including Optional Early Termination and Average Daily Trading Volume provisions.

> Complete reworking of the framework for Dividends.

> Brand new approach and architecture for settlement and determination of Equity Obligation Settlement Amounts.

> Application of the modular approach to and expansion of Settlement Disruption Events and Settlement Disruption Event Consequences.

Key new and revised risk allocation provisions

> Introduction of a Calculation Dispute Resolution Procedure setting out a detailed procedure for disputing Calculation Agent determinations as well as determinations of Cancellation Amount.

> Application of the modular approach to Extraordinary Events and their Consequences, so that parties are generally free to specify one or more consequences of an Extraordinary Event.

> A revised approach to Change in Law as well as the introduction of Transaction Illegality and Increased Performance Cost due to Change in Law as further change in law related Additional Disruption Events.

> Replacement of Hedging Disruption with Market Wide Hedging Disruption and Hedging Party Hedging Disruption Additional Disruption Events.

> Expansion of Loss of Stock Borrow and Increased Cost of Stock Borrow under the 2002 Definitions into seven securities borrowing related Additional Disruption Events.

> Introduction of Decreased Cost Events to accommodate decreased costs following the application of an Increased Cost Additional Disruption Event.

> Introduction of three new FX disruption related Additional Disruption Events covering FX Hedging Disruption, FX Inbound Valuation Disruption and FX Settlement Disruption.

> Expansion of Nationalization to cover governmental acquisitions over time and governmental interests in convertible instruments.

> Introduction of new Additional Disruption Events addressing Governmental Intervention.

> Complete reworking of Cancellation Amount.

What Next?

There is no official adoption date for the 2011 Definitions and market participants are, for the time being, expected to continue documenting equity derivatives transactions under the 2002 Definitions and various published MCAs, GTCs and product annexes.

Transition to the 2011 Definitions will be phased and implemented via industry adoption of ISDA Transaction Matrices.

The industry has committed to the global supervisors to:

> publish the first two ISDA Transaction Matrices and T-Supps for US and EU Variance Swaps by 31 August 2011; and

> identify additional products for development of related ISDA Transaction Matrices on a rolling quarterly basis commencing in October 2011.

In the meantime, it is anticipated that some parties may, when documenting new transactions, amend the 2002 Definitions to include functionality from the 2011 Definitions.

ISDA is also seeking to establish a new Equity Derivatives Determinations Committee structure over the coming year.

FAQs

Please see the detailed FAQs for further information.

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Further Information and Contacts

Linklaters acted as lead counsel to ISDA on the 2011 Definitions. For further information or assistance please contact one of the Linklaters 2011 Definitions team below or your usual Linklaters contacts:

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