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**Understanding the Trigger: CDS Credit Event
Determination and the Systemic Importance of
Sovereign CDS**

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Understanding the Trigger: CDS Credit Event Determination and the Systemic Importance of Sovereign CDS

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Agenda

- Credit Events
- Credit Derivatives Determinations Committees

2003 ISDA Credit Derivatives Definitions

Credit Derivatives Documentation

- 2003 ISDA Credit Derivatives Definitions
- May 2003 Supplement
- July 2009 (Restructuring) Supplement
 - These three docs together contain the basic credit derivatives concepts. They can be used to document both to standard, auction-settled transactions and more bespoke bilateral transactions.

2003 ISDA Credit Derivatives Definitions

Credit Events

- Six Credit Events.

** All Credit Events except Bankruptcy are triggered by the specific event occurring with respect to an Obligation (subject to the Payment Requirement or Default Requirement, if any). Bankruptcy is triggered by the specific event occurring with respect to the Reference Entity itself.

** Four Credit Events subject to Default Requirement (\$10m if not specified). Default Requirement not applicable in Bankruptcy and Failure to Pay Credit Events (although Payment Requirement is applicable to the latter (\$1m if not specified)).

Credit Events

Credit Events are defined in the 2003 ISDA Credit Derivatives Definitions, and will include some or all of the following:

- Bankruptcy
- Failure to Pay
- Obligation Acceleration (emerging markets entities) or Obligation Default (normally not chosen)
- Repudiation/Moratorium (sovereign entities)
- Restructuring

2003 ISDA Credit Derivatives Definitions

Bankruptcy Credit Event

- Bankruptcy language modeled on (but different from) Section 5(a)(vii) of the ISDA Master Agreement.
- Bankruptcy in Definitions and in Master Agreement have different purposes.

2003 ISDA Credit Derivatives Definitions

Failure to Pay Credit Event

- Failure to make, when and where due, any payments under one or more Obligations, after expiry of any relevant Grace Period.
- Payment Requirement threshold must be met before this Credit Event is triggered.
 - **Payment Requirement is \$1m if not specified otherwise in Confirmation.

2003 ISDA Credit Derivatives Definitions

Repudiation/Moratorium Credit Event

- Typically used in Sovereign and emerging market corporate credit default swaps.
- Amended test: (i) authorized officer of a Reference Entity or Gov't Authority repudiates or imposes moratorium *and* (ii) Failure to Pay occurs, determined without regard to Payment Requirement, or Restructuring occurs, determined without regard to Default Requirement. The aforementioned events in (ii) occur within 60 days of events specified in (i).

2003 ISDA Credit Derivatives Definitions

Restructuring

- Five triggers:
 - (i) interest rate reduction;
 - (ii) reduction in principal or premium;
 - (iii) postponement or deferral;
 - (iv) change in priority ranking of payments; or
 - (v) change in currency or composition of payment of principal or interest which is not a Permitted Currency.
 - The occurrence of, agreement to or announcement of any of the five triggers in circumstances where such trigger does not directly or indirectly result from a deterioration in the creditworthiness or financial condition of the Reference Entity or a technical adjustment occurring during the ordinary course of business shall not constitute a Restructuring.

2003 ISDA Credit Derivatives Definitions

- The change must occur in a form that binds all holders of the Obligation.
- Restructurings in context of bilateral loans prohibited from triggering Credit Event because Multiple Holder Obligation applies automatically, unless parties specify otherwise in Confirmation.
- Bilateral loan still deliverable if it otherwise meets definition of Deliverable Obligation.

2003 ISDA Credit Derivatives Definitions

- Multiple Holder Obligation means, at time of the event which constitutes Restructuring Credit Event:
 - a) the Obligation is held by more than three holders that are not Affiliates of each other
 - b) at least two-thirds of holders (as of the day of the event) are required to consent to the event which constitutes a Restructuring Credit Event.
- Two-thirds requirement deemed to be satisfied for Bonds.

2003 ISDA Credit Derivatives Definitions

- Parties have four choices with respect to Restructuring:
 - I. No Restructuring;
 - II. Full Restructuring (Section 4.7, without Section 2.32 or 2.33) “Old R”;
 - III. Modified Restructuring (Sections 4.7 and 2.32) “Mod R”; and
 - IV. Modified Modified Restructuring (Sections 4.7 and 2.33) “Mod Mod R”.

Credit Derivatives Determinations Committees

The ISDA Credit Derivatives Determinations Committees - An overview

- A Credit Derivatives Determinations Committee ("DC") currently exists in each of the following regions: the Americas, Asia excluding Japan, Australia-New Zealand, EMEA (Europe), and Japan.
- DCs make binding determinations for the CDS market as a whole
- Each DC deliberates issues involving Reference Entities traded under Transaction Types that relate to the relevant region, including Credit Events, CDS Auctions, Succession Events and other issues.
- The determinations made by the DCs are governed by the Determinations Committees Rules.

The ISDA Credit Derivatives Determinations Committees

- Composition of the DC
- 8 Global Dealers
- 2 Regional dealers per Region
- 5 non-dealer members
- 2 non-voting dealers
- 1 non-voting non-dealer

The ISDA Credit Derivatives Determinations Committees

- The non-dealer DC Representatives
- Membership of Non-dealer Committee
 - qualifications:
 - > \$1bn assets under management
 - > \$1bn CDS exposure
 - application to ISDA
 - approval by current committee

The ISDA Credit Derivatives Determinations Committees

- The non-dealer DC Representatives
- Selection at random
 - Staggered one-year terms

Questions