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Proposed Amendments to the 2003 ISDA Credit Derivatives Definitions – Implementation Timing Proposal and List of Key Changes

This note has been prepared by a working group under ISDA's Credit Steering Committee to provide guidance on proposed timing for implementation of a revised version of ISDA's Credit Derivatives Definitions and a high level description of key areas where the working group anticipates proposing changes to those Definitions. This note does not constitute legal advice to any interested person from ISDA or the Credit Steering Committee. Further, neither ISDA nor the Credit Steering Committee undertake any duty of care, nor shall they otherwise be liable, to any interested person.

An ISDA working group comprising members of ISDA's Credit Steering Committee (ISDA's product steering committee for credit derivatives) has been discussing proposals to amend the 2003 ISDA Credit Derivatives Definitions (the "Definitions"). This document contains a proposed timing for implementation of the updated Definitions and a list of the key areas where the working group anticipates proposing changes to the Definitions. Some of the areas listed below have been the subject of separate consultation papers that have been circulated to ISDA's Credit Derivatives Market Practice Committee for feedback (these consultation papers are available to ISDA member firms for review and references to those papers are included in footnotes below).

The purpose of this document is to provide guidance to market participants on the expected timing for implementing the new Definitions, i.e. when market participants may enter into new transactions using the new Definitions, and, for those elements of the new Definitions that are proposed to be included in a Protocol to allow parties to apply changes to existing transactions (but only if both parties to the transaction affirmatively adhere to the Protocol), when such changes would be effective. Although the new Definitions have not yet been finalized and published, the information below on the key areas of changes is intended to provide guidance on the impact of the changes at a high level. Before the new Definitions are finalized, a draft will be circulated to ISDA's Credit Derivatives Market Practice Committee and Documentation Committee for comments, therefore the descriptions below remain subject to comments received as part of that consultation. These committees are open to any ISDA member firms, including buy- and sell-side members.

Capitalised terms used in this memorandum but not defined herein shall have the meaning given to such terms in the Definitions.

(a) Implementation Timing

The documentation changes that will be necessary to implement the new Definitions will be:

(1) Final Definitions to be published.

(2) Either (A) updated forms of Confirmation-specific documentation (i.e. updated Physical Settlement Matrix and Matrix Confirmation for single-name trades, updated form of STS and Confirmation for index trades etc.) or (B) a Protocol that deems the necessary amendments to be made to future trades (for a limited period of time) so that parties can trade on the new terms before updated forms of Confirmation-specific documentation have been published.

(3) It is also anticipated that a Protocol would allow parties to apply some, but not all, of the proposed changes to existing transactions, if both parties to those existing transactions adhere to the Protocol. Parties that adhere to the Protocol would agree to make these changes with other adherents to the Protocol. Changes that are or are not anticipated to be included in a Protocol applicable to existing trades are set out in the relevant table in Part (b) below.

ISDA currently anticipates that the above documentation will be in place in order for contracts using the new Definitions to begin trading on March 20, 2014. Changes that parties agree to apply to existing transactions via a Protocol would go into effect on the same date. This timing is subject to consideration of issues related to clearing, in respect of both new and existing transactions.

(b) Key Areas of Changes to the Definitions

The tables below list the expected key areas of changes to the Definitions, with a high-level description of the changes envisaged in each case. The changes are grouped separately where they apply only to specific types of Reference Entity, with globally-applicable changes listed in the final table. The tables also indicate whether changes are anticipated to be included within a Protocol to allow parties to apply those changes to existing transactions. Generally, a change will be anticipated to be included within a Protocol where it is not expected to have a material economic impact on existing transactions, because a Protocol is only effective to amend a transaction when both parties to the transaction adhere. Where a change is expected to have a material economic impact on existing transactions, this would provide a disincentive for one party or the other to adhere to the Protocol, and so the Protocol would not be successful. Please note that some of these areas are still under discussion in concept, and these are highlighted in the tables below.

1. Changes applicable to new transactions only on financial Reference Entities (banks):

Topic	Description
Bail-in for financial Reference Entities ¹	For new transactions only on financial Reference Entities (banks): introduction of a new Credit Event triggered by a government-initiated bail-in (for example, pursuant to EU measures to be introduced in respect of financial institutions resolution and restructuring regimes). If the Reference Entity's debt is written down or converted into other assets as a result of the bail-in, the changes will provide for the CDS contract to be settled based on such written-down debt or other assets based on the outstanding principal amount of such debt before the bail-in. If the debt is written down to zero without any conversion proceeds, the CDS will effectively settle at a pre-determined fixed cash settlement amount of 100% in favour of Buyer. The new Credit Event would only be triggered by a bail-in of debt that is Not Subordinated to the Reference Obligation, so a bail-in of subordinated debt will not trigger the new Credit Event for a senior CDS contract. The changes also include a provision that senior and subordinated debt will be tracked separately for purposes of determining Successor Reference Entities. The changes would be implemented by introducing new Transaction Types for financial Reference Entities.

2. Changes applicable to new transactions only on Sovereign Reference Entities:

Topic	Description
Sovereign Asset Package ²	For new transactions only on Sovereign Reference Entities: introduction of the ability to settle a Credit Event by delivery of assets other than "Deliverable Obligations" as currently defined. The change would allow the CDS contract to be settled on the basis of an "asset package" into which pre-identified benchmark bonds of the Sovereign are converted on a Credit Event. The intention is to reduce the likelihood of sovereign bonds being restructured into non-deliverable obligations or obligations that are economically undesirable to deliver, leading to difficulties in settling sovereign CDS.

¹ Further detail on this proposal is available at: <http://assets.isda.org/media/59831c0b-2/3142139e.pdf>

² Further detail on this proposal is available at: <http://assets.isda.org/media/59831c0b-2/96d08313.pdf>

3. Possible changes applicable to transactions on Subordinated European Insurance Corporates:

Topic	Description
Subordinated European Insurance Reference Entities	For transactions that reference the Subordinated European Insurance Corporate Transaction Type: the working group is reviewing changes in the issuance structures of subordinated debt issued by European insurers, particularly with regard to the expected requirements of the European Solvency II Directive for Tier II debt. Consideration is being given to proposals in response to these changes. This topic remains subject to further discussion.

4. Changes applicable globally:

Topic	Description	Applicability to existing trades under Protocol
Restructuring Credit Event	Various changes, including: (a) for "Old" Restructuring, Credit Event Notice no longer to be required to trigger settlement following a DC Credit Event Announcement; (b) provision for legally binding Bond exchanges to trigger Restructuring; (c) clarification of impact of a currency redenomination in relation to Restructuring (this point remains subject to further discussion).	Anticipated to apply to existing trades
Mod R/Mod Mod R	Consideration is being given to proposals to amend the operation of Mod R / Mod Mod R settlement, including potentially reducing the number of maturity buckets and removing the need for Enabling Obligations. This topic remains subject to further discussion.	Application to existing trades to be determined depending on final proposal

Topic	Description	Applicability to existing trades under Protocol
Standard Reference Obligation ³	Introduction of standard Reference Obligations for more frequently-traded Reference Entities. The standard Reference Obligation would be published and would apply to all contracts that adopt “Standard Reference Obligation” (parties would be able to trade with a specific non-standard Reference Obligation if they wish). The new provisions would also standardize the procedures and standards for selecting a replacement Reference Obligation if the existing Reference Obligation is redeemed in full or in material part. Certain clarifications will also be made as to what happens if the Reference Obligation is redeemed or ceases to be an obligation of the Reference Entity.	Anticipated to apply to existing trades, but it is expected that parties will have a window following determination of a Standard Reference Obligation in respect of a Reference Entity and seniority level to “opt out” existing single-name CDS trades on a trade-by-trade basis. To preserve fungibility, the Standard Reference Obligation is anticipated to apply to Index and portfolio CDS trades without an opt-out.

³ Further detail on this proposal is available at: <http://assets.isda.org/media/59831c0b-2/96d08313.pdf>

Topic	Description	Applicability to existing trades under Protocol
Amendments to Successors provisions ⁴	<p>Various changes, including: (a) introduction of a “Universal Successor” concept to allow a Successor to be identified even if the succession is not raised within the 90-day lookback period, in circumstances where a Reference Entity transfers substantially all its assets and liabilities to another entity and then ceases to exist (e.g. upon a merger); (b) in the case of a non-Sovereign entity, to remove the need for a “Succession Event” to occur over and above the transfer of a sufficient amount of debt obligations to determine a Successor; (c) in light of the removal of the “Succession Event” requirement for non-sovereign Reference Entities, introduction of a “Related Event” concept that specifies when multiple debt transfers over a period of time should be aggregated to determine the proportion of debt that has moved to new entities; (d) amendments to the Sovereign Successor provisions to bring them in line with the debt transfer thresholds applicable to non-Sovereign Reference Entities.</p>	Anticipated to apply to existing trades.

⁴ Further detail on this proposal is available at: <http://assets.isda.org/media/59831c0b-2/96d08313.pdf>

Topic	Description	Applicability to existing trades under Protocol
Amendments to Qualifying Guarantee definition ⁵	Various technical changes, including: (a) providing that the inclusion of release provisions in connection with a the transfer to, or the assumption by, a single transferee of the guarantee and all (or substantially all) of the assets and liabilities of a guarantor on the same (or substantially the same) terms will not cause a guarantee to fail the “Qualifying Guarantee” standard; (b) providing that where an event of default causes release provisions in a guarantee to cease to apply and that event of default also constitutes a Credit Event, it should be assumed for the purposes of applying the “Qualifying Guarantee” standard that that event of default will not be cured; (c) providing that the inclusion of a cap on the guarantor’s liability, where the cap amount is sufficient to cover the principal amount of the underlying obligation, will not cause a guarantee to fail the “Qualifying Guarantee” standard (this point remains subject to further discussion); (d) removing the requirement for certain Qualifying Guarantees to be accelerated in order to be delivered; (e) clarifying that statutory guarantees may be Qualifying Guarantees.	Anticipated to apply to existing trades
Bankruptcy Credit Event	Some technical amendments, including clarification that the current references to “consolidation, amalgamation or merger” should instead refer to circumstances in which a Successor could be determined, and deletion of the reference to “official	Anticipated to apply to existing trades

⁵ Further detail on this proposal is available at: <http://assets.isda.org/media/59831c0b-2/96d08313.pdf>

Topic	Description	Applicability to existing trades under Protocol
	management". The "becomes insolvent" limb of the Definition may also be removed, pending confirmation from bank capital regulators that this would not negatively impact the regulatory capital treatment of CDS contracts.	
Outstanding principal balance	A proposed change to the "outstanding principal balance" and "Accreting Obligation" concepts to match more closely the outstanding principal balance of an obligation for purposes of settling CDS contracts with the size of the claim against the Reference Entity represented by that obligation. This topic remains subject to further discussion.	Anticipated to apply to existing trades
Deliverable Obligation Characteristics	The Deliverable Obligation Characteristics will be reviewed to see if any updates or clarifications should be made. This topic remains subject to further discussion.	Anticipated to apply to existing trades
Section 4.1	Section 4.1 will be reviewed to consider whether an obligation that is void or voidable at the time of issue should be capable of being a Deliverable Obligation. This topic remains subject to further discussion.	Anticipated to apply to existing trades
Articles I and III	The provisions in Articles I and III relating to the process for triggering settlement will be clarified and simplified to reflect market-standard contracts. These changes include simplification of the Event Determination Date and Publicly Available Information definitions and clarifications to the Notice of Physical Settlement, NOPS Cut-off Date and Settlement	Anticipated to apply to existing trades

Topic	Description	Applicability to existing trades under Protocol
	Suspension definitions.	