CDSClear on 2014 ISDA Definitions

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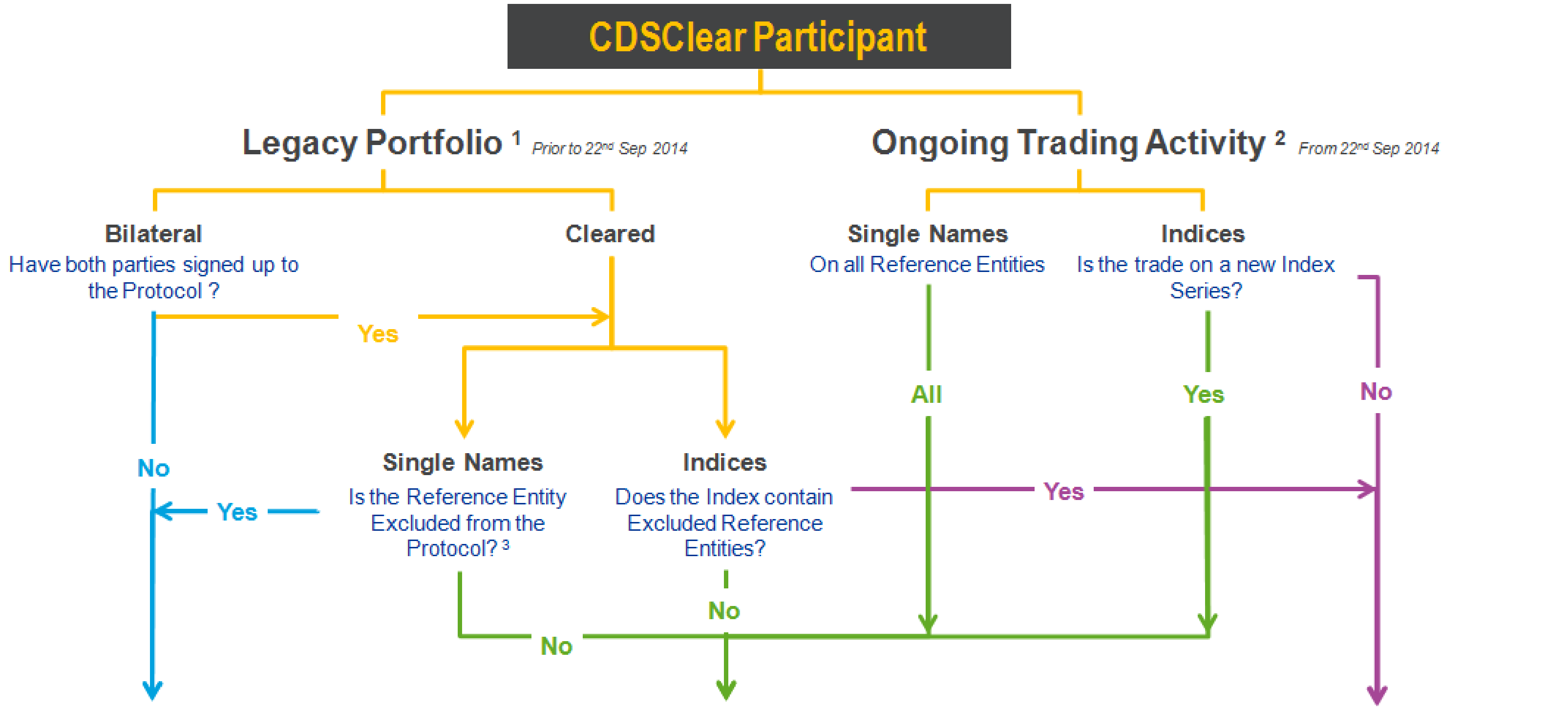
Contents

What are the 2014 Definitions?

The 2014 ISDA Credit Derivatives Definitions were published on 21 February 2014, as the new market standards for CDS transactions. The 2014 Definitions are the result of a comprehensive review and constitute a major update of the 2003 Definitions, with the goal to improve product mechanics in light of new occurrences in the market (such as bail-ins), and also incorporate some “lessons learned” from the market experience since 2009.

Trading and industry-wide implementation of the 2014 Definitions is scheduled to begin on 22 September 2014.

Are you impacted by the changes?



Stay on 2003 Definitions

- **Pricing & credit event management** – no change
- **Documentation** – no change
- **Systems** – enhance to transmit and manage the “definitions” field

Move to 2014 Definitions

- **Pricing & credit event management** – now based on updated definitions (general changes + product subset specific enhancements)
- **Documentation** – revised clearing house rules, updated execution agreements & associated papers
- **Systems** – enhance to transmit and manage the “definitions” field

Mixed Basket of 2003 & 2014

- **Pricing & credit event management** – Mixed
- **Documentation** – Mixed
- **Systems** – enhance to transmit and manage the “definitions” field

[1] Subject to the Protocol Effectiveness Condition being satisfied

[2] This diagram reflects the expected market standard for new trades done after 22nd Sep 2014. However, it is expected that other types of execution may remain possible, subject to liquidity on the relevant product

[3] The Excluded Reference Entity list will be published on ISDA website once finalized, certain Emerging Market names are likely to move from Excluded to included based on latest discussions

**Please note that the diagram serves as an illustrative guide only. We recommend that you liaise with your subject matter experts to gain a through understanding of the impact on your portfolio.*

Key changes - ISDA 2003 vs. ISDA 2014

Below is a summary of the most notable changes between the 2014 Definitions and the 2003 Definitions [1]

General Changes	
Update to Successor Provisions	• Debt movement without corporate event is sufficient for the determination of Successor • Debt transfers can now be considered over a period of time (Step Plan) • Creation of the concept of Universal Successor that can be determined outside the 90-Day look back period
Definition of Guarantee	• Expansion of the scope of guarantees that pass the test of being a "good" guarantee under the CDS Definitions and can therefore be hedged with a CDS contract
Standard Reference Obligation ("SRO")	• For some reference entities and seniority levels, an obligation will be selected to be the SRO and published on the SRO List. This SRO will then be used as the reference obligation for all market standard CDS contracts on that reference entity and seniority level
Adjustments to the Restructuring Mechanics	• Updates to Exercise Cut-Off Date in case of No Auction Announcement and to Movement Option Cut-Off Date • Removal of Enabling Obligations • Triggering without Credit Event Notice of transactions under "Old" Restructuring
Redenomination	• Provisions so that a debt change of currency following a Euro exit would not necessarily trigger a Restructuring

[1] This is a summary list only and therefore not a full, detailed analysis of the changes.

New trading standards for Financial Reference Entities	
Governmental Intervention Credit Event	• Introduction of a new government initiated bail-in trigger
Asset Package Delivery / Prior Deliverable Obligation	• Following a Restructuring or a Governmental Intervention, provisions allowing the delivery of proceeds (including non-cash assets) irrespective of their form, provided they are resulting from bailed-in obligations or restructured Reference Obligations that were deliverable immediately prior to the occurrence of the Credit Event
Distinction between Senior and Subordinated Transactions	• For the applicability of Credit Events, Senior Transactions will only be impacted by a Governmental Intervention or a Restructuring if Senior Obligations are impacted by the event • For Successor Provisions, senior and subordinated debt transfers will be tracked independently and will respectively impact the Senior or Subordinated Transactions

New trading standards for Sovereign Reference Entities	
Asset Package Delivery and Package Observable Bonds	• Provisions allowing the delivery of asset into which sovereign debt is converted

How do 2014 Definitions impact legacy trade populations?

For legacy transactions executed prior to 22 September 2014, ISDA will publish a Protocol allowing firms to amend from the 2003 to the 2014 Definitions, with the exception of contracts on certain excluded Reference Entities and products.

Excluded Reference Entities are sovereign entities, certain financial entities, and a few corporate entities. They are excluded from the Protocol because rolling existing CDS transactions in these reference entities to the 2014 Definitions would significantly change the terms of the contracts, hence cause biased economic impacts.

Therefore, existing single name transactions on an excluded reference entity will remain under the 2003 Definitions. The same convention applies for existing index transactions on “old” series but at constituent level: if an index constituent is an excluded reference entity then the corresponding portion of the index transaction will remain under the 2003 Definitions. Index constituents which are not excluded reference entities will migrate to the 2014 Definitions. The Protocol will therefore result in “mixed baskets” with some constituents subject to the 2014 Definitions and others remaining under the 2003 Definitions.

The Protocol adherence process is expected to run between the week starting 18 August up to 12 September 2014[2].

On 22 September, the 2014 Definitions will be implemented across the industry as per below:

- Execution of new transactions under the 2014 Definitions will become the market standard for all entities: corporate, sovereign and financials. This includes the use of new transaction types for financial entities and of the Standard Reference Obligation when available
- Execution of new transactions under the 2003 Definitions should remain possible, although the expectation is that this will mostly be used to hedge or unwind existing trades on excluded reference entities
- The updates from the Protocol take effect

Default can be triggered under one contract but not under the other as there are some material differences between the 2014 Definitions and the 2003 Definitions. Indeed, for the same Reference Entity, a specific event in the market may constitute a Credit Event under one set of Definitions but not under the other. Another scenario is for the same market event to result in a different Credit Event being determined, for instance a Governmental Intervention under the 2014 Definitions and a Restructuring under the 2003 Definitions.

[2] Adherence period and Implementation Date are subject to change. Application of the Protocol is subject to the Protocol Effectiveness Condition being satisfied. Please refer to the 2014 ISDA Credit Derivatives Definitions page for further details : http://www2.isda.org/asset-classes/credit-derivatives/2014-isda-credit-derivatives-definitions/

How do 2014 Definitions come into effect?

For bilateral transactions, adherence to the Protocol is voluntary. By signing up, parties agree to update all their existing protocol covered transactions facing all other adhering parties.

At CDSClear, the application of the Protocol will be directly incorporated within the CDSClear legal documentation (the "CDS Clearing Documentation"), and all cleared trade population will be rolled into 2014 Definitions where applicable. This approach is chosen to avoid basis risk being introduced into the CCP and ensures that all the existing cleared transactions covered by the Protocol are consistently updated to the 2014 Definitions across all Clearing Members and Clients.

From an operational processing perspective, there will be no need to cancel and rebook existing cleared transactions with us. CDSClear will automatically update the relevant cleared trades, and they will retain their current trade references. This process should minimise the impact for Clearing Members and Clients and assist with their reconciliation processes.

Please see below chart for a summary of existing trade population status at CDSClear post 22 September 2014:

		2003	2014	2003&2014 Mixed
Single Name Trades cleared before 22 September 2014	Excluded Reference Entities	✓		
	All other Reference Entities		✓	
Index Trades cleared before 22 September 2014	With Excluded Reference Entities as Constituents			✓
	Without Excluded Reference Entities as Constituents		✓	

Will CDSClear still offer clearing under the 2003 Definitions or will the service only clear 2014 contracts after 22 September 2014?

CDSClear will be able to accept all trades under 2014 Definitions, any single name trades that reference entities on our current list of clearable products which have been excluded from the Protocol, and index trades that are updated via the ISDA Protocol and already on our current list of clearable products.

CDSClear will NOT accept index transactions that have not been updated by the Protocol (all constituents under the 2003 Definitions).

			Definitions	Clearing Eligible
Current Clearing Eligible Single Names and Indices	**Single Names**	Excluded Reference Entities	2003	✓
		All other Reference Entities	2003	x
			2014	✓
	Indices	With Excluded Reference Entities as Constituents	2003	x
			2003 & 2014	✓
		Without Excluded Reference Entities as Constituents	2003	x
			2014	✓
New iTraxx Europe Series 22 (Main & Crossover) **issued on 22nd September 2014**			2014	✓

Will it be possible to take advantage of netting benefits between 2003 and 2014 definitions on the same entities?

From a trade management perspective, trades on 2003 and 2014 Definitions are not fungible and will not be netted together.

However, from a margin perspective, CDSClear calculations capture correlation offset between contracts on the 2003 and 2014 Definitions on the same entity while covering the spread risk and jump to default risk arising from these two different types of contract.

As an existing user of CDSClear, how does this affect the way I do business with you?

The 2014 Definitions do not have major functional impacts on existing clearing functionalities. CDSClear will continue to leverage its existing flows and processes for back-loading, intraday, compression, and EOD reporting. Clearing Members will only be required to update their processes to manage the new fields or new values contained within the existing flows.

There will be no action required from our Clearing Members regarding the legal documentation in place with us. The 2014 Definitions for cleared transactions will come into effect upon publication by CDSClear of the updated CDS Clearing Documentation.

As a potential/new user of CDSClear, is extra setup required other than the usual on-boarding process?

For potential/new users, there will be no extra setup required. The current on-boarding process will remain unaffected.

What preparations are underway at CDSClear ahead of the ISDA 2014 Definitions go-live?

Reference data update: Standard Reference Obligation provisions

CDSClear will apply the Standard Reference Obligation provisions to all cleared transactions governed by the 2014 Definitions. Therefore, CDSClear will use the SRO as the Reference Obligation to register a cleared transaction if the SRO is defined for the relevant Reference Entity / Seniority Level combination at the time of clearing. If there is no SRO defined at that time, CDSClear will use the CDSClear Preferred Reference Obligation (as per current process) and cleared transactions will be updated to the SRO upon its publication.

EOD price contribution process

Clearing Members will be required to provide prices on instruments for which they have an open interest, as they do today. CDSClear will leverage the existing process and technical flows for price contribution and enhance them to include the relevant data allowing the identification of the ISDA definitions that are applicable to each particular open interest. CDSClear approach is in line with the industry implementation by using the appropriate "doc clause" values.

Risk valuation and margin: for instance, how does CDSClear address basis risk due to bifurcated market on the same ref entity

The implementation of the 2014 Definitions does not require the creation of new margins. However, CDSClear has reviewed the calculations of some of the existing margins to adequately cover spread risk and jump to default risk arising from for the cohabitation of transactions under the 2003 and the 2014 Definitions.

Credit event management

CDSClear will implement automated processes to identify the trades impacted by a Credit Event based on the applicable ISDA Definitions and Transaction Type, in line with the determination from the ISDA DC. We will also implement the processing of the new Government Intervention Credit Event, which is treated within the 2014 Definitions as a "hard event" and shares many functional similarities with Bankruptcy or Failure To Pay.

EOD reporting

CDSClear will update its EOD reporting to enable full identification of the characteristics of the transactions. CDSClear approach will be aligned with the new fields and values implemented by the industry (i.e. Contractual Definitions, Doc Clause, and Transaction Types). The aim of this consistency is to minimise impacts on Clearing Members.

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Disclaimer

The contents of this document are for information purposes only and are subject to further discussions and modifications.

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