Small Bang: The Restructuring Supplement

15 things you need to know about the 2009 ISDA Credit Derivatives Determinations Committees, Auction Settlement and Restructuring Supplement

22 July 2009

1. When does the 2009 ISDA Credit Derivatives Determinations Committees, Auction Settlement and Restructuring Supplement (“July 2009 Supplement”) take effect?

The July 2009 Supplement will be effective from Monday 27 July 2009 for all credit derivatives transactions entered into after that date which incorporate the 2003 Credit Derivatives Definitions, as supplemented by the July 2009 Supplement. The “Small Bang” Protocol is open from 14 July to 24 July and will enable parties adhering to the protocol to apply the terms of the July 2009 Supplement to their existing credit derivatives transactions entered into with other adhering parties.

2. How does this inter-relate with the “Big Bang”?

The “Big Bang” refers to the March 2009 Supplement which introduced the Credit Derivatives Determinations Committee determinations and auction settlement into the 2003 Credit Derivatives Definitions in respect of Credit Events other than Restructuring. The “Small Bang” extends those terms to a Restructuring Credit Event, with amendments to accommodate the maturity limitations imposed by Modified Restructuring (ModR) and Modified Modified Restructuring (ModModR). By incorporating the July 2009 Supplement, parties are also incorporating all the terms of the March 2009 Supplement.

3. Why were amendments necessary for a Restructuring Credit Event?

The auction settlement provisions in the March 2009 Supplement did not apply to Restructuring due to the maturity limitation requirements imposed on Deliverable Obligations by ModR and ModModR which means that what may be a Deliverable Obligation for a CDS with one Scheduled Termination Date may not be a Deliverable Obligation for a CDS with an earlier Scheduled Termination Date. As the current auction methodology requires a single list of Deliverable Obligations for the auction, auction settlement cannot currently apply following a Restructuring.
4. **What amendments have been made to auction settlement for Restructuring?**

Rather than having one list of Deliverable Obligations and one auction in respect of a Restructuring Credit Event, Transactions and Deliverable Obligations will be allocated to eight different “Maturity Buckets” (with the possibility of a ninth, pre-2.5 yr Maturity Bucket for CDS which apply ModR). An auction will be held for each Maturity Bucket (provided sufficient Transactions and Deliverable Obligations have been allocated to that Maturity Bucket). *The term “Maturity Buckets” is not used in the July 2009 Supplement, which refers to “Limitation Dates”.

5. **What are the “Maturity Buckets”?**

The Maturity Buckets will have the following Maturity Bucket End Dates: 2.5yr/ModMod 5 yr**, 5yr, 7.5yr, 10yr, 12.5yr, 15yr, 20yr and 30yr. **This Maturity Bucket is referred to as the “ModModR 5yr Maturity Bucket” (where ModModR applies) and the “2.5yr Maturity Bucket” (where Mod R applies).

6. **How are Transactions allocated to Maturity Buckets?**

Transactions will be allocated to a Maturity Bucket depending on the Scheduled Termination Date: a Transaction is allocated to a Maturity Bucket if the Scheduled Termination Date is prior to the Maturity Bucket End Date of such Maturity Bucket (and after the Maturity Bucket End Date of the preceding Maturity Bucket) (subject to a Rounding Down Convention - see below). The exception to this is Seller-triggered Transactions: if the Seller triggers the credit protection, the Transaction will automatically be allocated to the 30yr Maturity Bucket regardless of the Scheduled Termination Date of the Transaction.

7. **How are the Deliverable Obligations for each Maturity Bucket determined?**

Deliverable Obligations are assigned to a Maturity Bucket if the final maturity date of that obligation is on or prior to the Maturity Bucket End Date (with the exception of the Mod/ModR 5yr bucket - Restructured Bonds or Loan with a final maturity date of up to 5yrs after the Restructuring Date will also be allocated to this bucket even though the Maturity Bucket End Date is 2.5yrs). Deliverable Obligations assigned to a Maturity Bucket will also be deliverable for the purposes of Maturity Buckets with longer dated Maturity Bucket End Dates.

8. **Will an auction be held for each Maturity Bucket?**

Not necessarily. The Determinations Committee will decide whether to hold an auction for a particular Maturity Bucket, consequently eight (or nine) different auctions may be held (or more if auctions are held for both senior and subordinated debt). If 300 Transactions, to which at least 5 dealers are
party, are triggered for any Maturity Bucket an auction will be compulsory. The auctions will be held on the same day. If Buyer triggers the protection and the Transaction is allocated to the 30 yr Maturity Bucket, that Transaction will not be settled in any auction for the 30 yr Maturity Bucket, but will be settled in accordance with the Fallback Settlement Method (cash settlement, if specified in the Confirmation, otherwise physical settlement).

9. **What if a transaction has been allocated to a Maturity Bucket for which no auction will be held?**

If a Transaction is assigned to a Maturity Bucket for which no auction is to be held either (a) the Buyer can move the CDS contract down to the Maturity Bucket with the next earliest Maturity Bucket End Date that is having an auction or (b) Seller can move the Transaction to the 30-yr Maturity Bucket. This is called the “Movement Option”.

10. **What if there is no auction for the Maturity Bucket and the Movement Option is not exercised?**

If no auction is to be held for a Maturity Bucket and the Movement Option is not exercised, Fallback Settlement will apply. When Fallback Settlement applies, if the Buyer triggered the protection, the only Deliverable Obligations that can be delivered are Deliverable Obligations with a final maturity date prior to the Maturity Bucket Limitation Date for such Maturity Bucket (i.e. Deliverable Obligations allocated to such Maturity Bucket and to all preceding Maturity Buckets).

11. **What if no Deliverable Obligations exist for the Maturity Bucket to which my transaction has been allocated?**

If a Transaction is allocated to a Maturity Bucket which contains no Deliverable Obligations with a final maturity date on or prior to the Scheduled Termination Date of such Transaction ("Eligible Obligations"), then that Transaction is moved down to a Maturity Bucket which contains Deliverable Obligations with a final maturity date prior to the Scheduled Termination Date of the Transaction. This is referred to as the “Rounding Down Convention” (this is not a defined term in the July 2009 Supplement).

12. **If the Determinations Committee determines that a Restructuring has occurred, does one of the parties need to send a Credit Event Notice?**

Unlike a non-Restructuring Credit Event, if the Determinations Committee determines that there has been a Restructuring Credit Event, an Event Determination Date will not occur automatically; the Buyer or Seller (depending on which party is the Notifying Party) must deliver a Credit Event Notice. If auction settlement applies and there are two Notifying Parties*, the parties must send the Credit Event Notice by a particular date (the Exercise Cut-off Date). * This is not immediately clear from the July 2009 Supplement, however the Exercise
Cut-off Date appears only to apply if auction settlement applies and there are two Notifying Parties.

13. What if the parties do not send the Credit Event Notice by the Exercise Cut-off Date?

If there is only one Notifying Party specified in the confirmation, then a Credit Event Notice can still be delivered before the end of the Notice Delivery Period, or if the DC has announced the occurrence of a Credit Event, within 14 days of the announcement, if later, however the Transaction cannot be subject to auction settlement.

14. What about the current requirement for Conditionally Transferable Obligation/Fully Transferable Obligation?

If the Buyer triggers the protection then each Deliverable Obligation allocated to any Maturity Bucket must still be a Conditionally Transferable Obligation (for ModModR) or a Fully Transferable Obligation (for ModR). These requirements do not apply if the Seller triggers the protection.

15. What if the Determinations Committee is not requested to determine whether a Restructuring has occurred?

The parties can still trigger the protection by delivering a Credit Event Notice, however the Credit Event Look Back Period introduced by the March 2009 Supplement sets a deadline by which either a Credit Event Notice must be delivered or the Determinations Committee must be instructed to decide whether a Credit Event has occurred. This applies equally to all Credit Events and consequently, means that a party may lose its protection if it does not deliver a Credit Event Notice with 60 days of the Restructuring Date.

“The Credit Event Look Back Period introduced by the March 2009 Supplement sets a deadline by which either a Credit Event Notice must be delivered or the Determinations Committee must be instructed to decide whether a Credit Event has occurred.”
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