

Standardization of CDS Contracts

Presentation to the ECB Euro system
Meeting

Frankfurt, Feb 24th, 2009

ISDA®

International Swaps and Derivatives Association, Inc.

Outline

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- Industry Initiatives
 - Participants
 - Automation
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 - Standardized Contract Terms
- Central Clearing Needs
- Progress Report
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Context

- Since 2005, the industry has been working on improving the CDS post-trade infrastructure
- Initiatives have steadily expanded to include the automation of the whole post-trade processing space
 - Paperless Straight Through Processing
 - The Trade Warehouse: Centralized depository of all trades
 - Compression initiatives : initiatives to reduce outstanding volumes by eliminating economically offsetting trades
 - Fixed Coupons : Replace all existing contracts with 100/500 coupons
 - Standardized Contract Terms (Restructuring Events, Effective Date, Reference Obligations, etc.)
- The central clearing initiatives benefit from these efforts

Participants

- These initiatives have been a joint effort of the OTC derivatives industry in conjunction with the regulators
 - Facilitated by the NY Fed with broad participation of other foreign regulators
 - Driven by leading industry participants under the auspices of ISDA
 - Representatives from global and regional banks
 - Buy-side participation
 - The industry has committed large amounts of resources to these initiatives – both in terms of man hours as well as other resources
 - Many people have been working in ISDA/OMG sponsored groups
 - Vendors (DTCC, Markit, T. Zero, Tri-Optima and others) have dedicated a lot of resources to these initiatives
- These initiatives are **global**
 - OTC derivatives is a global business
 - The needs are common to most participants around the globe
 - The solutions sought are addressing global needs
 - Participants from around the globe

Progress in Automation

- **Electronic Processing:**
 - Percentage of trades confirmed electronically in the high 90s
 - Novation process completely electronic
 - Gates to the Trade Warehouse completely automated for close to 99% of trades
- **Trade Warehouse**
 - Contains close to 99% of outstanding trades; efforts under way to capture the remaining trades
 - DTCC issues weekly reports on size of the market, and activity as well as information for most referenced entities
 - Information, in the DTCC website, is available to all
- **Compression**
 - A very large % of outstanding notional amounts has already been compressed

Standardized Contract Terms

- Treatment of “Restructuring” as a credit event
 - Dropped for US referenced names
 - On-going discussions for European referenced names
- Fixed Coupons
 - New CDS contracts (from March 20th, onwards) will have standard coupons of 100 and 500 basis points
 - Old trades will be converted via compression
 - Agreed for North American names
 - In discussions for European names
- Effective Dates
- Removing the reference obligations

Hardwiring

- A major undertaking to build the auction process into the 2003 Credit Derivatives Definitions
 - It was the intention to “hardwire” since the Auctions were established
 - Initiative received new impetus after the Fed request in late 2007
- In practical terms this initiative involves the following steps:
 - Issuance of a Supplement to the 2003 Credit Derivatives Definitions
 - Establishes the Credit Derivatives Determinations Committees
 - Adds the Auction Settlement Provisions
 - Implements the “60-day Look-back” Provisions
- Publication of a “big bang” Protocol to upgrade existing transactions

Hardwiring – Cont'd

- **Determinations Committees (DC)**
 - One for each region: Americas, Europe, Japan, Australia-NZ, Asia Ex-Japan
 - Comprising global and regional dealers, plus buy-side
 - ISDA is DC Secretary
- **Remit of DCs**
 - Determine key issues:
 - Credit Events (Type, dates and when)
 - Auctions Events (yes/no, approval for participation, amendments to the auction methodology)
 - Deliverable Obligations
 - Succession Events
 - Any other determinations relevant to the CDS market
- **Provisions for External Review Panel if no consensus**

Progress Report - Next Steps

- Drafts of Supplements, Auction terms, DC Rules and Protocol
 - Drafts have been circulated to ISDA membership
 - Comments have been received and considered
 - Comment period is now closed
- Final review is ongoing
- Publication of Supplement and Protocol: Early March 2009
- Effective March 20th, 2009

Central Clearing Needs

- **Standardization of contracts is a requirement of any clearing initiative**
 - Standardized contract terms initiative
 - Fixed coupons initiative
 - “Hardwiring” the credit event treatment
- **Backload existing contracts**
 - The existence of the Trade warehouse
 - CCP connectivity with Trade Warehouse
 - Ability to “re-coupon” existing transactions
 - Ability to deal with “restructuring”

Remaining Tasks

- Work remains to be done with the treatment of “restructuring” as a credit event
- Other items to be discussed?

Conclusions

- The CDS market is a “young” market; about 10 years old with most growth having taken place over the past 5 years
- Despite its “youth”, the industry, worldwide, has made tremendous progress over the past 5 years in putting in place a robust and automated infrastructure
- The central clearing initiatives will benefit from the work that has already been performed as well as other initiatives under way

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