Standardization of CDS Contracts

Presentation to the ECB Euro system Meeting
Frankfurt, Feb 24th, 2009
Outline

• Context
• Industry Initiatives
  – Participants
  – Automation
  – Hardwiring
  – Standardized Contract Terms
• Central Clearing Needs
• Progress Report
• Remaining Tasks
• Conclusions
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 of 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
• **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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