

# Current Issues in European CDS

June 8<sup>th</sup> 2009



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# Session One: North American and European Convention Changes

June 8<sup>th</sup> 2009



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## Panellists

- Charlie Longden (moderator), Markit
- John Cortese, Barclays Capital
- Arne Groes, BNP Paribas
- Jeff Kushner, BlueMountain Capital Partners



# Agenda

- Recap of North American convention changes
- Convention changes two months on – observations
- European convention changes
- Observations on European changes and differences to North America



## North American convention changes

- Fixed coupon of 100 and 500
- Full first coupon
- No restructuring
- Standard North American Contract (SNAC)
- All applied from April 8<sup>th</sup>, 2009



## Why 100 / 500 coupons?

- Representative of the distribution of credits:
  - Many High Yield and Distressed credits already traded Points upfront + 500
  - 100 bps represented the tighter IG names
- Two coupons necessary for re-couponsing of old trades
- 100 / 500 enabled the market to deal with credit migration from high grade to high yield
- Feedback across market participants was that 100 / 500 works best (as opposed to say 50 / 1000)



# Trading and quoting conventions

- **Trading Conventions**
  - Both 100 and 500 Fixed Coupons will settle on Points Upfront
- **Quoting Conventions**
  - 100 Fixed Coupon: Conventional Spread
  - 500 Fixed Coupon: Points Upfront
  - Entities could trade with either 100 or 500
  - Liquidity typically migrated to a single coupon
- **Conventional spread = Quoted spread**
  - Spread equivalent of the upfront fee based on standard assumptions
  - Industry tools available for conversions (e.g. Markit converter - [www.markit.com/cds](http://www.markit.com/cds))
- **Par Spreads**
  - No longer seen in dealer runs for North American corporate CDS



## Points for discussion

- Why move to fixed coupon?
- Why quote 100s as conventional spreads, not upfronts?
- Observations two months on – how did the changes go?



## European convention changes

- Similar to North American convention changes
- Fixed Coupon of 25, 100, 500 or 1000
  - IG names likely to trade at 100, HY at 500 (as in US)
- Additional coupons at 300 and 750 for re-couponsing of old trades
  - May be offered for new trades but likely to be illiquid
- First full coupon
- Proposed implementation date of June 20<sup>th</sup> 2009
- Restructuring to remain in the European contract
  - Auction process to be amended to allow for restructuring credit events (Small Bang)



## Points for discussion

- What is driving the European changes?
- Why the differences to North America?
  - 4 coupons
  - 2 additional coupons for re-coupons
- What are the practical implications of making the changes?



# Questions and Answers

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Session Two:  
Restructuring and its  
Impact on the Auction  
Process

June 8<sup>th</sup> 2009



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## Panellists

- Tom McNerney (moderator), Markit
- Paul Glasgow, JPMorgan
- Andrew Downes, UBS
- Simon Davidson, Credit Suisse
- Athanassios Diplas, Deutsche Bank



# Agenda

- Big Bang Protocol review
  - Determinations Committees
  - Hardwiring of the auctions
  - Look-back period for credit and succession events
  
- Restructuring – an overview
  - Introduction
  - Evolution
  - Definition
  - Key characteristics
  
- The “Small Bang Protocol”
  - Goal
  - Practical implications

# Big Bang Protocol

- **Determinations Committees**
  - 5 regional committees
    - Buy-side and sell-side representation
  - Determines whether a credit or succession event has occurred
  - Decides if an auction will take place and determines auction parameters
  - Publishes the list of deliverable bond obligations
- **Hardwiring of the auction**
- **Look-back period**
  - Changes the concept of protection start date
  - Rolling 60 days for credit events and 90 days for succession events
- **Expressly excludes auction determination for restructuring events**

# Restructuring – key characteristics

- Definition: A debt obligation is considered restructured if there's at least one of:
  - Interest rate reduction
  - Reduction in principal
  - Postponement or deferral of interest or principal
  - Change in the priority ranking of payments
  - Change in currency or payment composition of principal or interest
  
- The above criteria have to result from a deterioration in the creditworthiness or financial condition of the reference entity
  
- Company remains solvent
  - Longer dated bonds at a discount
  - Maturity limitation in place to avoid buyers from triggering and delivering bonds cheaper than the restructured bond (that they would be hedging)
  
- In North America historically difficult to find a consensus
  - Liz Claiborne loan modification
  
- Absence of chapter 11 bankruptcy and Basel II make restructuring more relevant in Europe

# Maturity limitation

- Buyer and seller can trigger the contracts in case of a restructuring
  - Buyer may choose to wait for a hard credit event (failure to pay, bankruptcy) expecting a larger payout
  - Seller triggers if he believes that the loss in perspective is bigger in case of a hard credit event
  - Longer-dated non-restructured bonds trade at a discount to short-dated bonds giving an “unfair advantage” to buyers

## **Introduction of the Maturity limitation concept to avoid delivery of non-restructured obligations trading at a deep discount**

- Applies only when the buyer of protection triggers, applies to each deliverable obligation
- Mod-R: Earlier of Restructured Date + 30 months and latest final maturity date of any restructured bond/loan
- Mod-Mod-R: Later of the STD and Restructured Date + 60 months (restructured obligation) or Restructured Date + 30 (all deliverable)



## Restructuring next steps

- Define how auctions should be set up to handle restructuring credit events
  - Using the current definitions, there would need to be one auction per Scheduled Termination Date
- Allow the Determination Committee to determine auction(s) and deliverable obligations
- Proposed Solution: The Small Bang Protocol

# Small Bang Protocol

- Hardwires the auction mechanism for restructuring credit events
- Defines maturity buckets for deliverables following a restructuring credit event
  - Proposed 5 buckets for Mod-Mod-R based on existing contract
    - Seller – 0 to 30 year
    - Buyer – 2.5, 5, 7.5, and 10 year buckets
  - DC would decide whether to hold at least one auction
  - DC would decide what buckets would have an auction based on debt issuance and volume of triggered contracts
  - DC would decide the deliverables for each auction bucket
- ‘Use it or lose it’ feature
  - If there is an auction, the trades that aren’t triggered before the auction will not be able to be triggered afterwards



# Questions and Answers

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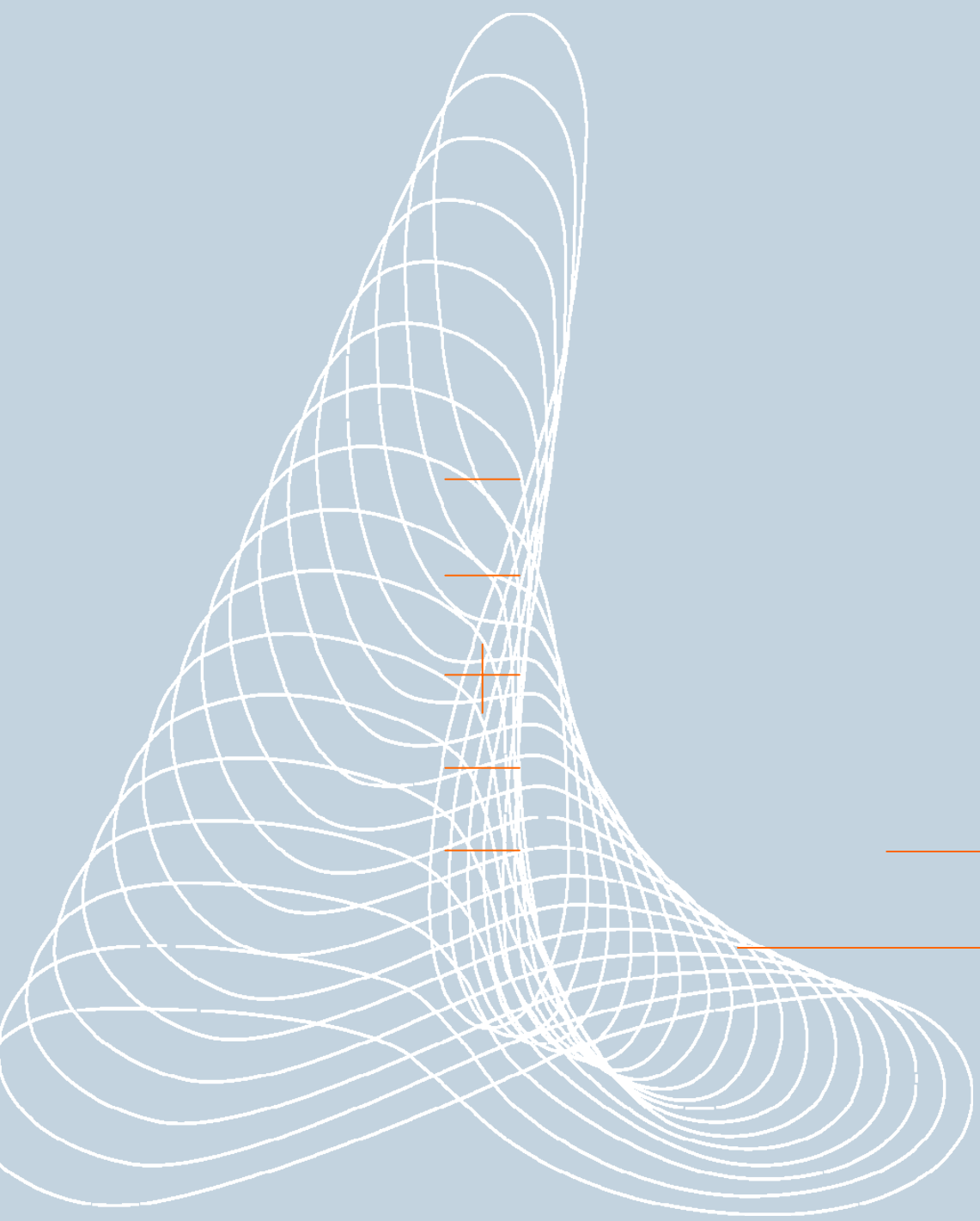
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## Session Three: Regulatory and Clearing Update

June 8<sup>th</sup> 2009



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## Panellists

- Jeff Gooch (moderator), Markit
- Anne Wetherilt, Bank of England
- David Bailey, FSA
- Tim Frost, Cairn Capital
- Richard Metcalfe, ISDA

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