

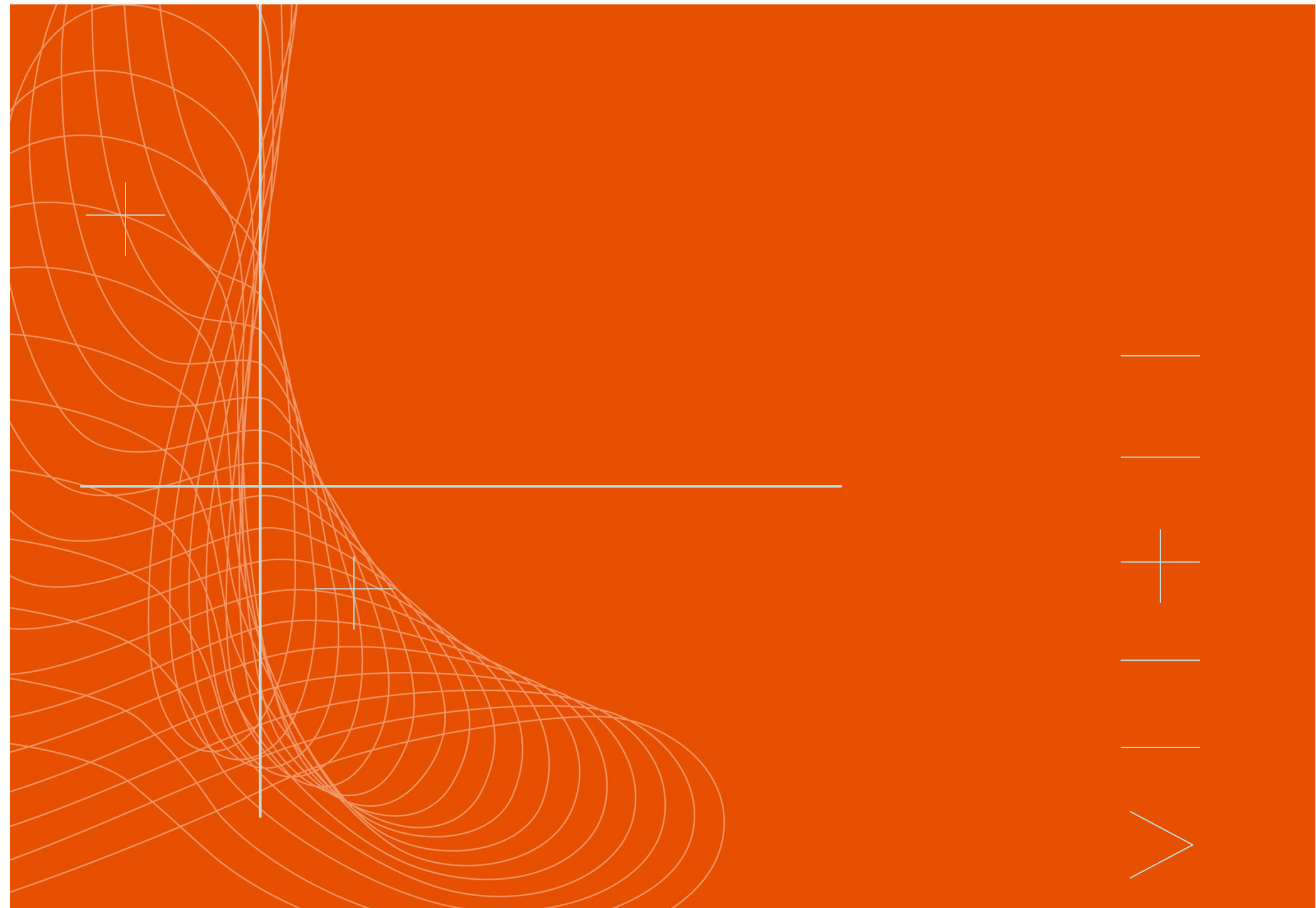


Current Issues in North American CDS

January 29, 2009



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North American CDS: Issues for Discussion

January 29, 2009



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Panelists

- Ed Chidsey (moderator), Markit
- Tom Benison, JPMorgan
- Athanassios Diplas, Deutsche Bank
- Paul Hamill, Barclays Capital
- James Hill, Morgan Stanley



Issues For Discussion

- Background
- Hardwiring of the Auction Mechanism
 - Auction overview
 - Hardwiring proposal
 - No restructuring
- Dispute Resolution
 - Event Determination Committee
- Standardized Effective Dates
- Standardized Coupons and Full Accruals
- Elimination of Reference Obligations
- Timing of the Process

North American CDS: Trading Issues

January 29, 2009



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Panelists

- Tom Price (moderator), Markit
- Bis Chatterjee, Citigroup
- Andy Hubbard, Credit Suisse
- Jason Quinn, Barclays Capital



Outline

- Why Fixed Coupons?
- Why 100/500?
- Importance of the Standard Converter
- Expected Quoting Methodology & Price Submission
- Portfolio Re-couponsing with 100/500
- Other Related Key Initiatives

Why Fixed Coupons?

- Makes single name CDS More “CDX Like”
- Transacting is simplified – “The price is the price” (use of flat curve - 40% recovery on all trades)
- Fungible contracts enhance unwinds, assignments and eligibility for central clearing

	Markit CDX	Proposed SN CDS Changes
Fixed Coupon	✓	✓
Exchange Upfronts	✓	✓
Standard Effective Date In the Past	✓	✓
Standard Accruals and Full Coupon	✓	✓
No Restructuring	✓	✓



Why 100/500 Coupons?

- Representative of the distribution of credits today:
 - Many High Yield and Distressed credits trade Points upfront + 500 currently
 - 100 bps represents the tighter IG names
- Two coupons necessary for re-couponsing of old trades
- 100/500 would also enable 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)



Importance of Standard Converter

- Since every trade will have an upfront payment, it is critical for the market to avoid increasing operational burden by creating payment breaks
- Creates a standard that is used industry wide- the code is easy to replicate and can reside in multiple locations but deliver the same results
- Allows automation of post-trade process
- Availability of Markit standard converter/calculator (also possibly available on other platforms)



Expected Quoting Methodology & Price Submission

- Most HY names will be quoted in points upfront
- IG credits expected to be quoted in spread (like CDX.IG), not upfront points
 - This is consistent with how the market is currently quoted
 - Reduces the amount of modifications the market has to adapt to
 - Names tighter than 100 would have to be quoted as ‘negative points upfront’ which could create confusion
- End of day marks submitted to Markit (for investors and clearing houses) for all credits- IG and HY for both the 100/500 coupons
- Markit will publish as end of day levels quoted spreads/par spreads/points

Portfolio Re-coupling with 100/500

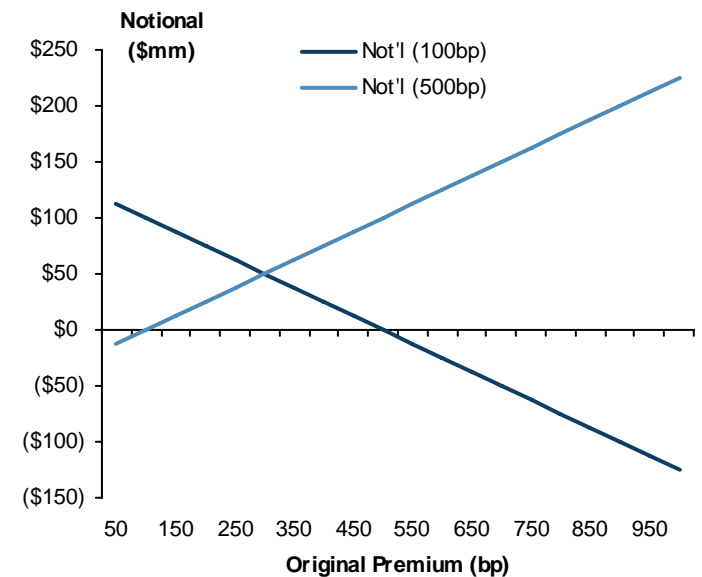
- Converts non 100/500 trades into two trades with strikes of 100 and 500
- The two new trades together have exactly the same convexity, jump-to-default, running payment, etc. as the original
- While the trade population doubles initially, it enhances the ability to assign or unwind and net all trades to one position

Original Trade

CDS Size (\$mm)	\$100
Premium (bp)	50 bp
Premium/yr	\$500,000

Repricing Metrics		Compression Size (\$mm)	Cash Flow
Notional A (bp)	100 bp	\$112.5	\$1,125,000
Notional B (bp)	500 bp	(\$12.5)	(\$625,000)
Total		\$100	\$500,000

Portfolio Re-coupling Notional on \$100m Position





Other Related Key Initiatives – Under Discussion

- To Ensure Fungibility:
 - Standard rolling effective dates (Today – X days convention) for all trades
 - No Restructuring as standard (for North America)
 - Auction protocol hardwiring on all trades
 - Standard accruals (All trades will include accrued)
 - Removal of Reference Obligations
 - Standard Dispute Resolution mechanism



Appendix

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Dealer Runs

- Current Runs (Par Running Spreads)

-TECHNOLOGY-			-TECHNOLOGY-		
ARW	210-220	+12	CSCO	140-150	+15
AVT	285-295	+20	ORCL	145-155	+15
CSC	135-145	+10	DELL	225-235	+20
EDS	55- 60	--	HPQ	115-120	+20
WU	250-260	+5	IBM	117-122	+22
CA	265-275	+20	PBI	120-125	+5
MOT	370-380	+10	IKNq	80-100	+10
SUNW	180-190	+10	XRX	485-505	+30
TXN	85- 95	+5	GLW	300-325	+30

- Proposed Runs

- 100 bps as "Quoted Spread"

ARW	220-230
AVT	285-295
XRX	465-586

- 500 bps as Points Upfront

ARW	4 ½ - 5
AVT	5 - 5 ½
XRX	10-10 ¼

*Numbers above for illustrative purposes only. The numbers do not represent a conversion of the quoted spread into an upfront. The example is meant to illustrate the format and appearance we expect.



Standard Model & Inputs

- Standard Code
 - Open Source
 - Based on standard industry model
- Standard Inputs
 - Yield Curve
 - Standard source
 - Timing: Prior end of day snap
 - Assumed Recovery
 - 40% for Senior
 - 20% for Subordinated

Markit Converter and Calculator

- Markit Calculator
 - Full set of open fields
 - Defaults to standard assumptions
- Markit Converter
 - Implementation of the code
 - Assumptions built in
 - Easy to use
 - Calculation of upfront
- Benefits
 - Standard implementation
 - Confirm implementation of the code
 - Agree on upfront payments
- Prevent trades from breaking on different upfront amounts
 - #1 reason for Index trades breaking
- Everyone has the same process to getting to one price



North American CDS: Operational Considerations

January 29, 2009



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Topics

- Introduction – Marc Barrachin (moderator), Markit
- Industry Goals – Darren Thomas, UBS
- Current Status – Guy Gurden, Markit
- Standardization – Gregg Rapaport, DTCC
- Trade Capture – Frédéric Crosnier, Goldman Sachs
- Post Trade Processing – Frédéric Crosnier



Key commitments to the Fed

- Commitments for credit derivatives market outlined by Operations Management Group (OMG) in Oct 31, 2008 letter to the Fed
- Major themes
 - Central Counterparty Clearing
 - Portfolio Compression
 - Reduce outstanding notional and trade count
 - Electronic Processing
 - Life Cycle Event Processing

Key commitments to the Fed

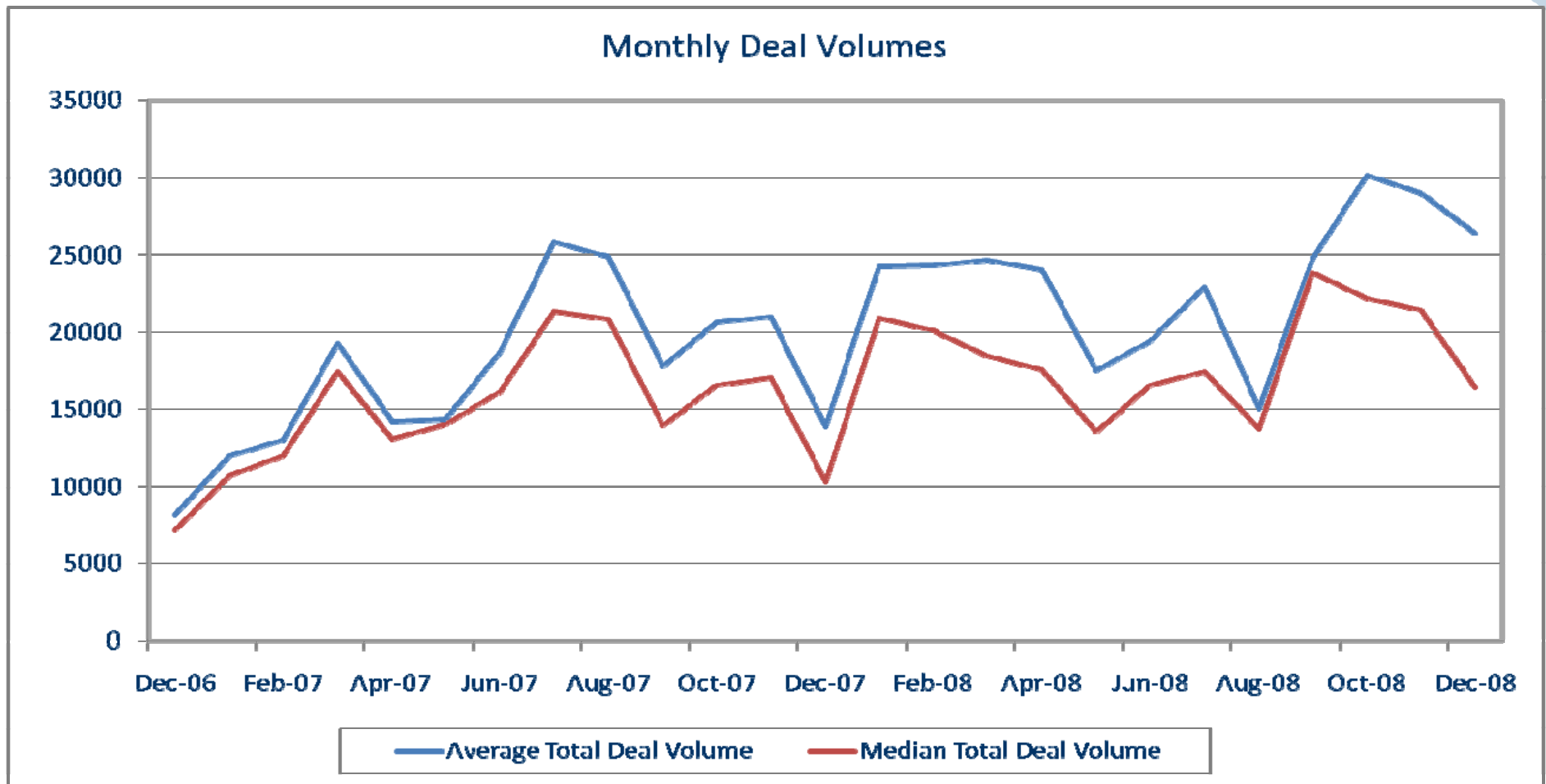
- Electronic processing
 - Submission timeliness: By Jun 30, 2009: T+0 (trade date) submission target of 85% across all trades, including novations
 - Submission accuracy: By Jun 30, 2009: 94% accurate first time submission of all trade types, including novations (confirmation without modification)
 - Confirmation timeliness: 95% T+5 confirmation target (unchanged from Jul 2008 letter)



Current Status

- **Portfolio Compression**
 - Over \$2 trillion single name gross notional reduction
 - Indices
- **Current regulatory reporting via Markit Metrics**
 - Quarterly results are made public on www.markit.com
- **Highlights from the December 2008 metrics**
 - Some of the highest monthly deal volumes seen during Q4 2008
 - 96% of total volume now confirmed electronically
 - Over 98% of total volume now eligible for electronic confirmation

Credit Derivatives

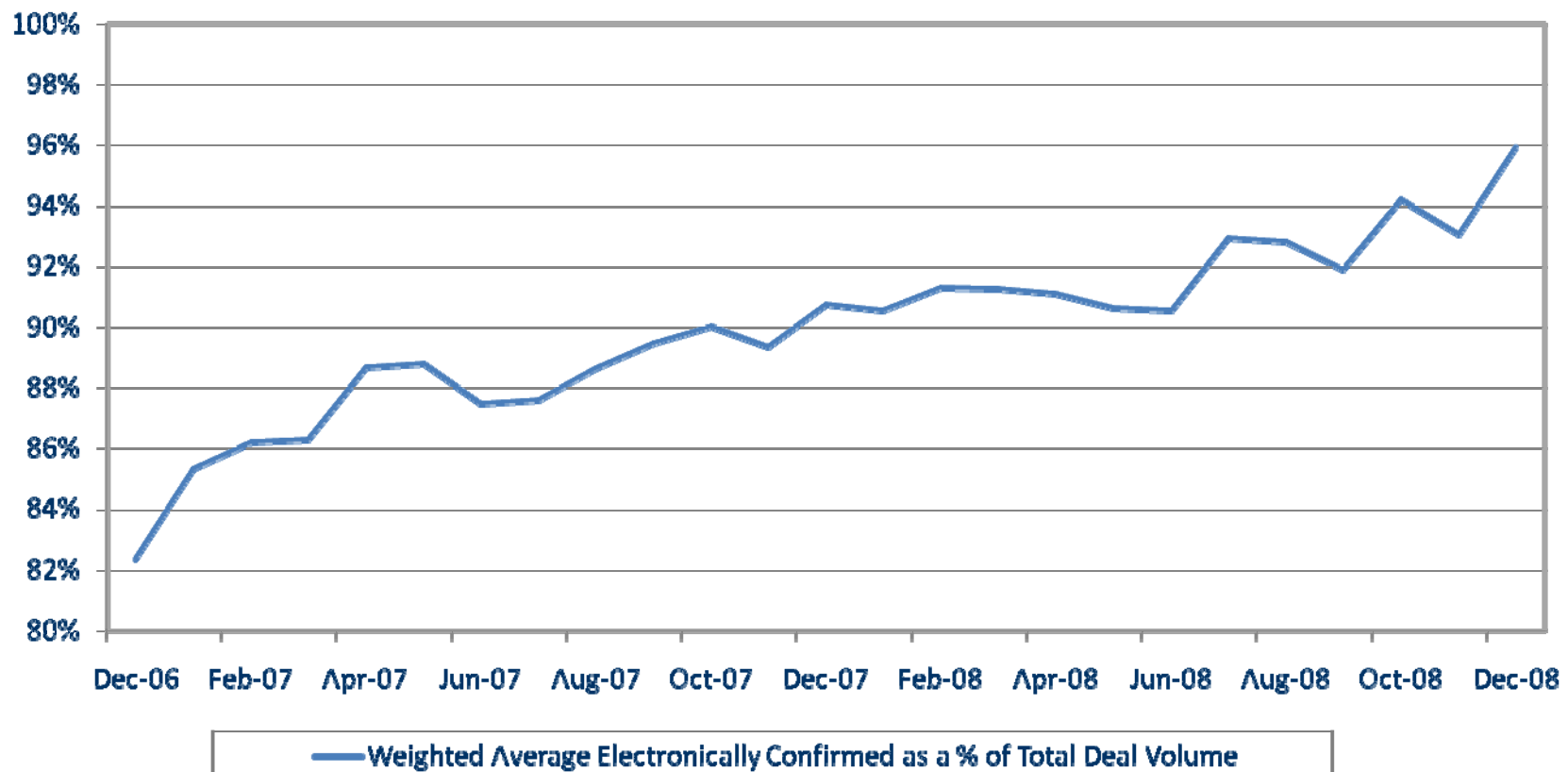


Note – Average Volume per reporting dealer

Quarterly Trend Report December 2008

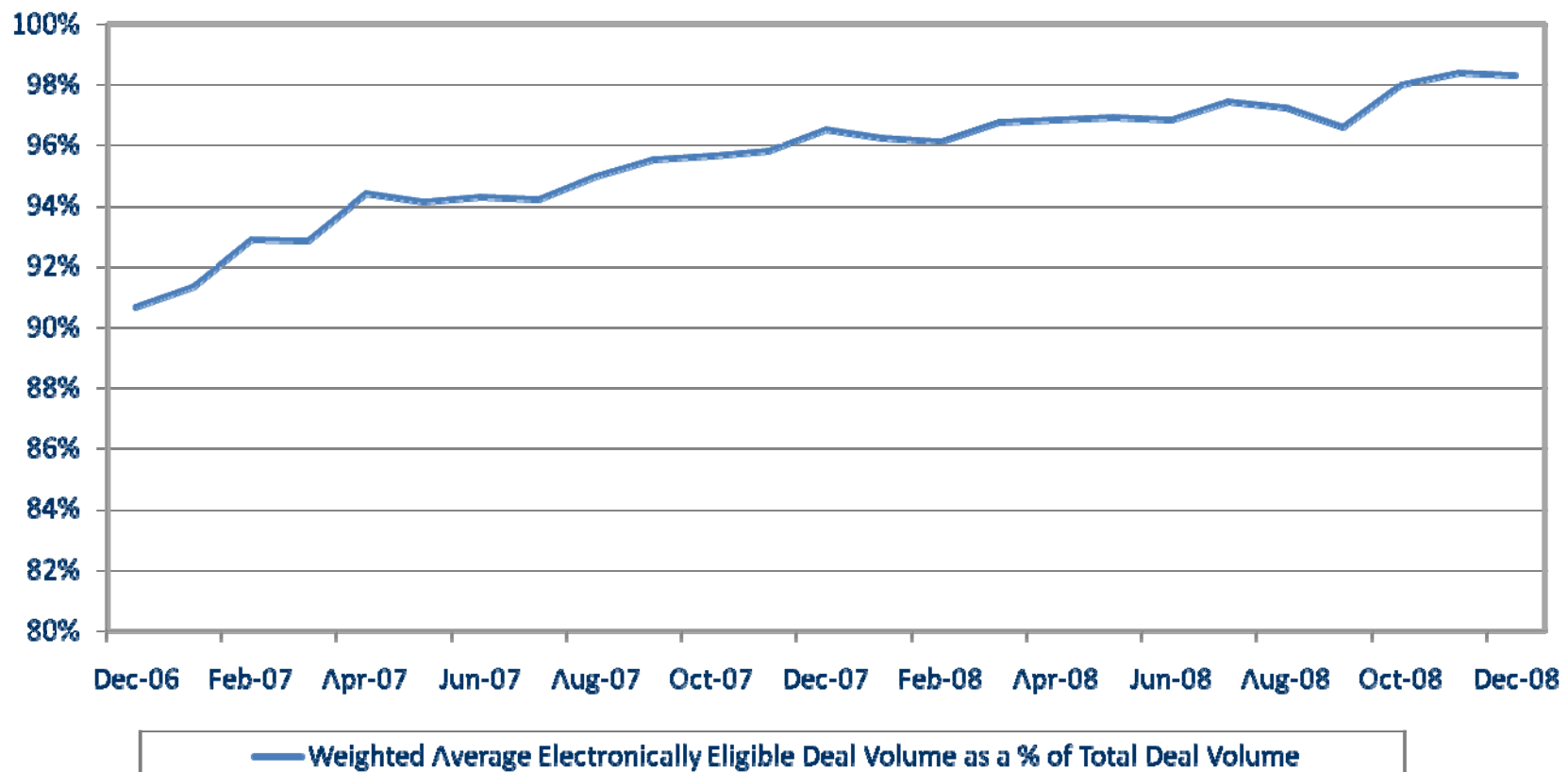
Credit Derivatives

Electronic Volume as a % of Total Volume



Credit Derivatives

Electronically Eligible Volume as a % of Total Volume



Standardization & Improving Confirmation

- Roadmap
 - Confirm correctly the first time
 - Submission speed
 - Fixing of breaks after initial submission
- Break issues can still exist
 - Reference Entity
 - Notional
 - Counterparty
 - But these should be readily known by front office!



Standardization & Improving Confirmation

- Standardize more fields
- Create an overwrite mechanism at DTCC
- Fees
 - Standard model available
 - Standard input available
- Reference obligations



Trade Capture

- Enhance trade capture
 - Standardize document type
 - Overwrite vs. reject
 - Standardized Markit RED
 - RED6 – 3A7486 (General Motors Corporation)
 - RED9 – 3A7486SNR
 - Reference Obligation – ZZSENIOROBL1



Post Trade Processing

- Event Processing
 - Credit Event
 - Succession Event
- Novation Processing
 - Electronic Confirmation
- Portfolio Compression



Questions?