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3 April 2009

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## **2009 ISDA Credit Derivatives Determinations Committees and Auction Settlement Supplement to the 2003 ISDA Credit Derivative Definitions**

This advice is given on the 2009 ISDA Credit Derivatives Determinations Committees and Auction Settlement Supplement (“**March 2009 Supplement**”) to the 2003 ISDA Credit Derivative Definitions (“**2003 Definitions**”) published by the International Swaps and Derivatives Association, Inc. (“**ISDA**”).

This advice replaces our earlier advice to you on credit derivatives documentation dated 19 June 2003.

In this advice, we set out:

- the materials which we have reviewed;
- our opinion;
- the qualifications to which this opinion is subject;
- a brief discussion of the key changes made by the March 2009 Supplement; and
- an outline of Australian legal and regulatory issues which arise in connection with the entry into credit derivative transactions.

In this advice we do not comment on the Protocol which ISDA has published in order to facilitate the variation of existing (and, for a limited time, future) transactions to, amongst other things, include the March 2009 Supplement. This is the subject of a separate advice from us dated on or about the same date as this advice.

### **1 Materials reviewed**

1.1 We have reviewed the following documents published by ISDA:

- (a) the 2003 Definitions; and
- (b) the March 2009 Supplement.

The 2003 Definitions, as supplemented by the March 2009 Supplement, are referred to in this letter as the “**Credit Derivative Definitions**”.

- 1.2 Terms used but not defined in this letter have the meaning given to them in the Credit Derivative Definitions. If a term has different meanings in the 2003 Definitions and the March 2009 Supplement, when used in this letter the term takes the meaning given to it in the March 2009 Supplement.
- 1.3 In this letter, we make no comment on any ISDA Definitions or other ISDA documentation other than the Credit Derivative Definitions.

## 2 **Opinion**<sup>1</sup>

- 2.1 If there is no connection between the Reference Entity and the Buyer (including by the Buyer having credit exposure on the Reference Entity) or between the Reference Entity and the Seller at any time then the Credit Derivative Definitions, of themselves, give rise to no regulatory or legal issues under the laws of the Australian Jurisdictions applicable to Credit Derivative Transactions<sup>2</sup> generally and which do not apply to other derivative transactions.

It may be that, in a particular factual scenario, a regulatory or legal issue will arise in connection with the Credit Derivative Definitions and a Credit Derivative Transaction, such as whether a particular event constitutes a Credit Event or a Succession Event or whether a particular obligation is an Obligation or a Deliverable Obligation. However, these issues are dependent on the particular facts surrounding the relevant Credit Derivative Transaction on which we cannot meaningfully comment in this letter.

- 2.2 In our opinion, a vanilla Credit Derivative Transaction entered into under the terms of the Credit Derivative Definitions:
  - (a) would not constitute an insurance contract for the purposes of the common law definition of insurance in the Australian Jurisdictions unless there are relevant factual circumstances which result in the Credit Derivative Transaction being characterised as an indemnity for loss;
  - (b) would constitute a derivative under the *Corporations Act 2001* (Cth) (“**Corporations Act**”); and
  - (c) would not be invalid or unenforceable on the grounds that it constitutes a gambling contract under the gambling legislation of the Australian Jurisdictions.

Our reasoning for this is contained in paragraph 5.

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<sup>1</sup> This opinion remains subject to the detailed reasoning and the assumptions and qualifications contained in this letter.

<sup>2</sup> Please see paragraph 3.3 for a further explanation

- 2.3 If there is a connection between the Reference Entity and the Buyer or between the Reference Entity and the Seller then there are other regulatory and legal issues which could arise under the laws of the Australian Jurisdictions, particularly in connection with:
- (a) duties of confidentiality owed to the Reference Entity;
  - (b) possession of inside information on the Reference Entity;
  - (c) defamation of the Reference Entity;
  - (d) dealings with the Reference Entity; and
  - (e) insolvency of the Reference Entity if it is also the Seller.

These issues are briefly described in paragraph 6.

### 3 **Qualifications**

- 3.1 Mallesons Stephen Jaques is qualified to advise on the laws of the Commonwealth of Australia, New South Wales, Victoria, Queensland, Western Australia and the Australian Capital Territory ("**Australian Jurisdictions**"). We express no opinion about the laws of any other jurisdiction and the opinions expressed in this analysis are limited to the laws of the Australian Jurisdictions.
- 3.2 We make no comment on:
- (a) taxation issues, including in respect of stamp duty and goods and services tax;
  - (b) the enforceability of any particular Credit Derivative Transaction or Novation Transaction;
  - (c) issues which may arise in connection with ability to perform the settlement of any Credit Derivative Transactions in the manner set out in the Credit Derivative Definitions, such as the ability to Deliver particular Deliverable Obligations or issues arising in attempting to settle a transaction which has become subject to an illegality under the laws of the Australian Jurisdictions;
  - (d) the regulatory capital treatment of, or accounting issues in connection with, credit derivatives;
  - (e) amendments and supplements to the Credit Derivative Definitions other than those expressed above to be included in the definition of "Credit Derivative Definitions" for the purposes of this advice. Please note that the Credit Derivative Definitions are drafted on the assumption that the parties have entered into a 2002 ISDA Master Agreement;
  - (f) legal or regulatory matters which arise in connection with derivatives generally. For example, we do not comment on the requirement to hold an Australian

Financial Services Licence in order to “deal” in derivatives under the Corporations Act or the ability to bind a Calculation Agent which is not a party to the Credit Derivative Transaction; or

- (g) the commercial effect of the Credit Derivative Definitions or whether the terms of the Credit Derivative Definitions reflect current Australian or international market conventions or practice. For example, we make no comment on the appropriateness or suitability of any formula, election, timing or quotation conventions contained in the Credit Derivative Definitions. We assume that every market participant will make its own independent assessment as to whether they will adopt the Credit Derivative Definitions.

3.3 This opinion is given in respect of the Credit Derivative Definitions when used only to document vanilla Credit Derivative Transactions, meaning single name auction-settled, cash-settled or physically-settled credit default swaps. The Credit Derivative Definitions do not address first-to-default credit swaps, portfolio credit default swaps or total return swaps, although they can be adapted for this purpose. However, if the Credit Derivative Definitions are adapted appropriately<sup>3</sup>, then our opinion contained in paragraph 2.1 should also be applicable to the Credit Derivative Definitions in these circumstances. In addition, in these circumstances, the principles underlying our opinion set out in paragraph 2.2 would be applicable, but it would be necessary to review the terms of the relevant Credit Derivative Transaction before the manner of application of those principles to that type of transaction could be confirmed. However, this opinion has no application to transactions which involve a financial product that is linked to a Credit Derivative Transaction, such as synthetic credit-linked notes or collateralised debt obligations.

3.4 This opinion is of general legal advice only. This analysis is not intended to be an opinion upon which market participants can rely in actual situations. This is because the application of the Credit Derivative Definitions to a particular transaction ultimately depends on the terms of the transaction and the relevant facts. Accordingly, while every care has been taken in preparing this analysis, Mallesons Stephen Jaques does not accept responsibility for any losses suffered or liabilities incurred arising from use of this analysis in respect of a particular transaction.

## 4 Summary of key changes made in the March 2009 Supplement

### *Overview*

4.1 The March 2009 Supplement effects some fundamental changes to the way in which Credit Derivative Transactions (“**Transactions**”) operate.

4.2 Parties to existing or legacy Transactions and future Transactions entered into on or before 31 January 2011 which incorporate the 2003 Definitions can also incorporate the March 2009 Supplement into the terms of those Transactions by adhering to the 2009 ISDA Credit

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<sup>3</sup> With drafting that ensures that all provisions are effective and in accordance with the parties’ commercial intentions.

Derivatives Determinations Committees and Auction Settlement CDS Protocol (the “**Protocol**”) in respect of which we have issued a separate opinion<sup>4</sup>.

4.3 Parties can also incorporate the March 2009 Supplement into their Transactions by expressly stating in the relevant Confirmation that the March 2009 Supplement applies.

4.4 The March 2009 Supplement implements five main concepts:

- (a) adds Auction Settlement as a new Settlement Method;
- (b) establishes the Credit Derivatives Determinations Committees (each a “**Determinations Committee**”) and incorporates the Resolutions of each Determinations Committee into the Credit Derivatives Definitions;
- (c) creates Credit Event Backstop Dates and Succession Event Backstop Dates;
- (d) changes the determination of the currency exchange rate for Physical Settlement; and
- (e) compression of the settlement process for (i) Loan Deliverable Obligations and (ii) physical settlement of Auction RASTs, Customer Buy RASTs and Customer Sell RASTs resulting from an Auction.

### ***Auction Settlement***

4.5 The March 2009 Supplement implements a new Settlement Method for Transactions, referred to as Auction Settlement<sup>5</sup>. Together with the establishment of Determinations Committees, this is arguably the most fundamental change to the 2003 Definitions since they were published.

4.6 Through the “hardwiring”<sup>6</sup> process, the March 2009 Supplement together with the Protocol, will replace the individual *ad hoc* protocols for future Auctions and ISDA will **not** publish individual protocols for standard CDS Auctions going forward.

4.7 A Transaction will settle by Auction Settlement if it is elected by the parties as the Settlement Method (with parties specifying either Cash Settlement or Physical Settlement as their Fallback Settlement Method) and an Auction Final Price Determination Date occurs. Auction Settlement may only be elected for Auction Covered Transactions. We have set out in paragraph 4.10 the types of Transactions specifically excluded from Auction Settlement<sup>7</sup>.

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<sup>4</sup> See opinion of Mallesons Stephen Jaques to AFMA dated on or about the date of this advice.

<sup>5</sup> Section XII of the March 2009 Supplement.

<sup>6</sup> This term is used to refer to ISDA incorporating Auction Settlement into its standard documentation for existing or legacy, novated (through the Protocol) and future (through the incorporation of the March 2009 Supplement) Transactions.

<sup>7</sup> This list is similar (but not identical) to transactions excluded from previous individual CDS auction protocols.

- 4.8 If Auction Settlement applies and an Auction Final Price Determination Date occurs, Seller pays to Buyer the Auction Settlement Amount on the Auction Settlement Date. The Auction Settlement Amount uses the Auction Final Price resulting from the relevant Auction in accordance with the form of Credit Derivatives Auction Settlement Terms published by ISDA in respect of that Auction.<sup>8</sup>
- 4.9 However, a Transaction will not settle by Auction Settlement (and the parties shall, subject to the occurrence of a Credit Event and the satisfaction of the Conditions to Settlement, perform their respective payment and delivery obligations in accordance with the Fallback Settlement Method) if:
- (a) ISDA announces that an Auction is cancelled under Section 13(e) of the Auction Settlement Terms;
  - (b) ISDA announces that no Auction is announced;
  - (c) ISDA publicly announces that the relevant Determinations Committee has Resolved, following a Credit Event Resolution Request Date, not to determine whether or not an event constitutes a Credit Event for the purposes of the relevant Transaction;
  - (d) ISDA publicly announces that the relevant Determinations Committee has Resolved that an event that constitutes a Restructuring for purposes of the relevant Transaction has occurred<sup>9</sup>; or
  - (e) an Event Determination Date was determined pursuant to Section 1.8(a)(i) and no Credit Event Resolution Request Date has occurred within three Business Days of such Event Determination Date.

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<sup>8</sup> In summary, the auction methodology and mechanics are based on those used in ISDA's previous CDS auction individual protocols. During an Auction, Participating Bidders submit firm bids and offers, on behalf of themselves and their clients, to the auction administrators who determine the Auction Final Price for Deliverable Obligations of the affected Reference Entity. The firm bids and offers are made in respect of a Representative Auction-Settled Transaction ("RAST") which is a CDS but on terms such that it takes effect as a bond sale and purchase of cheapest to deliver Deliverable Obligations, at Auction Final Price, and with standard CDS non-delivery fall-backs. Once an Auction Final Price is determined, only a small number of RASTs physically settle; all other RASTs cash settle using the Auction Final Price determined by the Auction. If a party wishes to physically deliver the Deliverable Obligations specified in any Auction, that party will need to enter a Physical Settlement Request (if that party is a Participating Bidder) or a Customer Physical Settlement Request (if that party is not a Participating Bidder), as applicable. A more detailed analysis of the auction methodology is publicly available on ISDA's website ([www.isda.org](http://www.isda.org)) as a pdf "plain English summary" for previous CDS auction individual protocols.

<sup>9</sup> This does not preclude an Auction being held in the future following a Restructuring Credit Event but means that at the moment (by incorporation of the March 2009 Supplement in its current published form), it is **not mandatory**, i.e. parties will not be required to settle by Auction. This means that Restructuring can still be a Credit Event for Transactions but that if a Restructuring Credit Event occurs, a separate individual auction will be held and adherence to such a CDS auction protocol will be voluntary.

## *Transactions not settled by Auction Settlement*

- 4.10 All Transactions may become subject to Auction Settlement other than those Transactions specifically excluded from the definition of Auction Covered Transaction<sup>10</sup>. These are:
- (a) any Bespoke Portfolio Transaction (i.e. a Transaction that references more than one Reference Entity (i) that references a portfolio of Reference Entities that is substantially identical to the relevant portfolio of Reference Entities for any series of credit linked notes, trust certificates or other similar instruments and (ii) the documentation for which expressly states that the final price is linked to such credit linked notes, trust certificates or other similar instruments, as applicable);
  - (b) any Reference Obligation Only Transaction (i.e. where Settlement Method is Physical Settlement and “Reference Obligation Only” is specified as the Deliverable Obligation Category or Settlement Method is Cash Settlement and the relevant Confirmation specified only one or more specifically identified Reference Obligations);
  - (c) any Loan Only Transaction (i.e. “Loan” is specified as the only Deliverable Obligations or the Reference Obligations (which are required to be Loans) and certain other Loans (or Borrowed Money obligations other than Bonds) are the only Deliverable Obligations)<sup>11</sup>;
  - (d) any Preferred CDS Transaction (i.e. references preferred securities or similar hybrid securities as Reference Obligations or Deliverable Obligations and which contains specific provisions pertaining thereto);
  - (e) any Fixed Recovery Transaction (i.e. where the Final Price or final settlement amount is pre-determined and specified);
  - (f) any Credit Derivative Transaction that (i) by its terms expressly states that the provisions relating to settlement therein shall not be amended or modified by any Credit Derivatives Auction Settlement Terms or any documentation with respect to an auction published by ISDA and (ii) would, but for such express terms, be an Auction Covered Transaction; and
  - (g) any back-to-back Credit Derivative Transaction between any two of Citigroup Global Markets Limited, Credit Suisse First Boston International, Deutsche Bank AG, Goldman Sachs International, JP Morgan Chase Bank, Merrill Lynch International, Morgan Stanley Capital Services Inc. and UBS AG London Branch relating to trust certificates linked to any Dow Jones CDX.NA.HY Index or CDX.NA.HY Index.

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<sup>10</sup> This definition and related definitions are set out in schedule 1 to this opinion

<sup>11</sup> We understand that Loan Only Transactions are excluded from Auction Settlement so as to maintain the existing market practice, under which these types have been settled pursuant to separate auction rules and settlement terms published by ISDA.

- 4.11 In addition to the above list, parties to a Transaction can incorporate the March 2009 Supplement but bilaterally agree to exclude the application of Auction Settlement in respect of that Transaction.

***Credit Derivatives Determinations Committees***

- 4.12 The March 2009 Supplement provides for the establishment of a Determinations Committee for each Region which will be established and governed by the Rules set out in Annex A to the March 2009 Supplement.

- 4.13 A Determinations Committee will be formed for each of the following Regions:

- (a) the Americas;
- (b) Asia Ex-Japan;
- (c) Australia-New Zealand;
- (d) EMEA (Europe); and
- (e) Japan.

Following effective receipt of a request for a meeting of a Committee, ISDA, acting in its capacity as Determinations Committee Secretary, shall determine the relevant Region of an Affected Reference Entity based on the Transaction Types in the version of the Physical Settlement Matrix most recently published by ISDA as of the date of effective receipt of that request.

- 4.14 Each Determinations Committee will include the following members:

- (a) 8 Global Dealer Voting Members;
- (b) 2 Regional Dealer Voting Members;
- (c) 5 Designated Non-dealer Voting Members;
- (d) 1 Designated Global Dealer Consultative Member (for the first year, there will be 2 of these);
- (e) 1 Designated Regional Dealer Consultative Member; and
- (f) 1 Designated Non-dealer Consultative Member.

- 4.15 Each Determinations Committee Member generally serves a one-year term, with non-dealer members serving on a staggered one-year basis.

- 4.16 Any party to a Transaction incorporating the March 2009 Supplement can request that a meeting of a Determinations Committee be convened<sup>12</sup>. A Determinations Committee in respect of the relevant Region will be convened if at least one member of the relevant Determinations Committee believes that such question merits deliberation. A list of standard questions is set out in Schedule 1 of Annex A to the March 2009 Supplement to assist the Determinations Committee Secretary in phrasing the Determinations Committee Questions for a Determinations Committee to consider.
- 4.17 A Determinations Committee may be convened to Resolve (and can reverse) any of the following:
- (a) whether a Credit Event has occurred (and the type, date and date on which the Determinations Committee Secretary effectively received valid Credit Event Notice and Notice of Publicly Available Information);
  - (b) whether to hold an Auction to settle a Credit Event and other auction related determinations, such as the terms specific to a particular Auction<sup>13</sup>;
  - (c) the Deliverable Obligations to be valued in any Auction held to settle a Credit Event and determinations related to Deliverable Obligations<sup>14</sup>;
  - (d) the existence and relevant dates of Succession Events and determination of any Successor related to such Succession Event;
  - (e) the identity of and determinations related to Substitute Reference Obligations;
  - (f) the occurrence of a Potential Repudiation/Moratorium;
  - (g) whether a merger, consolidation or amalgamation of Reference Entity and Seller has occurred;
  - (h) the documentation to be used to determine whether a Loan has been Delivered for the purposes of physical settlement; and
  - (i) any other matter of contractual interpretation relevant to the credit derivatives market generally (not being a matter of bilateral dispute solely between two Eligible Market Participants).

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<sup>12</sup> Section 2.1(a) of Annex A of the March 2009 Supplement: *"In order to convene a Committee, an Eligible Market Participant must request a meeting of a Committee by notifying the Determinations Committee Secretary of the issue(s) it believes should be deliberated by such Committee."*

<sup>13</sup> For example, Auction may not be required for an Affected Reference Entity that is not in an index or is insufficiently traded.

<sup>14</sup> For example, where Transactions in respect of the Affected Reference Entity specify "Bonds or Loans" or "Bonds" as Deliverable Obligations, the Determinations Committee will decide whether to run two separate auctions or whether one auction can be run together. As a Determinations Committee only has 10 days to review the Deliverable Obligations, the list specified for an Auction will not be exhaustive.

- 4.18 Each Determinations Committee Resolution will be binding, to the extent relevant, on parties to a Transaction that incorporates the March 2009 Supplement.
- 4.19 Each Determinations Committee has the power to refuse to decide a question in which case the parties must reach their own conclusion on the relevant question or the Calculation Agent will make the relevant determination in the same way as previously under the 2003 Definitions.
- 4.20 All Determinations Committee deliberations are confidential until the relevant information is published. The Determinations Committee Secretary will publish on the ISDA website:
- (a) all meeting requests and the supporting information submitted along with such request;
  - (b) each convening of a Determinations Committee and the questions to be deliberated;
  - (c) each decision of a Determinations Committee to not deliberate an issue, transfer a question or dismiss a question;
  - (d) each binding vote of a Determinations Committee, along with the identity and vote of each member; and
  - (e) any other information relation to the deliberations of a Determinations Committee that a Determinations Committee decides to publish by 50% majority.
- 4.21 Parties to a Transaction waive their rights to bring claims (other than in respect of fraud and wilful misconduct) against the Determinations Committee and third parties hired under the Rules in performing their duties.
- 4.22 Each Determinations Committee must achieve at least 80% consensus in order to Resolve any Determinations Committee Questions and if less than an 80% supermajority vote is attained, then the relevant Determinations Committee Question will be referred automatically to a panel of external reviewers chosen randomly from a pool composed of individuals nominated by ISDA Members and approved by a majority of the members of the relevant Determinations Committee.

### ***Credit Event and Succession Event Backstop Dates***

- 4.23 New definitions of Credit Event Backstop Date (*Section 1.23*) and Succession Event Backstop Date (*Section 2.2(i)*) have been inserted. These definitions create rolling “look-back” periods with respect to Credit Events and Succession Events, so that all Transactions have retroactive exposure regardless of their Trade Date.
- 4.24 The Credit Event Backstop Date is 60 calendar days prior to (i) the date of the request for the Determinations Committee to convene to determine the existence of the Credit Event, or (ii) the date on which both a Credit Event Notice and Notice of Publicly Available Information (if applicable) are effectively delivered.

- 4.25 The Succession Event Backstop Date is 90 calendar days prior to (i) the date of the request for the Determinations Committee to convene to determine the existence of the Succession Event, or (ii) the date on which a Succession Event is effectively delivered. The fact that information in respect of Succession Events can take longer to reach the market and can be more difficult to determine than a Credit Event is reflected by the longer “look-back” period.
- 4.26 These changes mean that parties have a limited period during which to act on a Credit Event or Succession Event under their Transaction. Irrespective of the Trade Date or Effective Date of a Transaction, a Credit Event and/or a Succession Event can be triggered only if that event occurred within the 60 (in the case of a Credit Event) or 90 (in the case of a Succession Event) calendar days before the requests or notices described above are effective. If the relevant event occurs more than 60 or 90 calendar days, as appropriate, before the requests or notices described above are effective, then the occurrence of that event will not affect the Transaction.
- 4.27 A further important consequence to note is that, unlike the 2003 Definitions, it is now possible that a Transaction could be affected by a Credit Event or a Succession Event that took place *before* the Trade Date or the Effective Date of a Transaction.
- 4.28 The rationale for these changes is to achieve consistency and fungibility between Transactions that would be otherwise identical, were it not for two Transactions having different Trade Dates and Effective Dates, so that any such two Transactions can be settled as though they were completely back to back and perfectly hedged. This also facilitates the compression of CDS transactions.

### ***Currency Rate***

- 4.29 The definitions of Currency Amount (*Section 8.9*) and Currency Rate (*Section 8.10*) have been amended and new definitions of Revised Currency Rate (*Section 8.12*), Next Currency Fixing Time (*Section 8.13*) and Currency Rate Source (*Section 8.14*) inserted.
- 4.30 The changes made by the March 2009 Supplement lock in the Currency Rate for each Deliverable Obligation, and determine the Currency Rate for each updated Deliverable Obligation based on the one that it replaced. The impact of these changes is as follows:
- (a) the Currency Rate is set on the Business Day (or two Business Days)<sup>15</sup> prior to the Auction Date by reference to the WM/Reuters London 4pm mid-point rate;
  - (b) the Notice of Publicly Available Information is required to be delivered on the Business Day following the Auction Final Price Determination Date<sup>16</sup>, thereby minimising FX risk; and

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<sup>15</sup> As per the definition of “Auction Currency Fixing Date” defined in Section 18 of the Credit Derivatives Auction Settlement Terms, dependent on the Relevant Transaction Type.

<sup>16</sup> As per the definition of “Notice of Physical Settlement Date” defined in Section 18 of the form of Credit Derivatives Auction Settlement Terms.

- (c) if there is any change in the Notice of Publicly Available Information, the Currency Rate for the new Deliverable Obligation is determined by reference to the spot rate between the currency of the outgoing Deliverable Obligation and that of the incoming Deliverable Obligation, as next published by the WM/Reuters at 4pm London time.<sup>17</sup>

4.31 Amendments were made to address:

- (a) perceived issues with Section 8.10 of the 2003 Definitions providing Buyer with an opportunity to amend its Notice of Publicly Available Information purely to take advantage of currency fluctuations and the situation where if a Notice of Publicly Available Information was amended, the Currency Rate for each Deliverable Obligation in the Notice of Publicly Available Information would be updated, regardless of whether each such Deliverable Obligation was replaced; and
- (b) the fact that in previous auctions, there was no mechanism for performing currency conversions for a Participating Bidder or Customer calculating its Market Position and if a Participating Bidder's Physical Settlement Request takes into account numerous Customer Physical Settlement Requests and one Customer amends its Notice of Publicly Available Information, the Participating Bidder has a mismatch regardless of what it does.

### ***Physical Settlement***

- 4.32 The definition of Deliver (*Section 8.2*) has been amended<sup>18</sup> to provide that if a Determinations Committee recommends market advisory documentation customarily used in the market for Delivery of the Loan specified then use of that market advisory by the parties to Deliver the Loan is mandatory<sup>19</sup>.
- 4.33 The form of Credit Derivatives Auction Supplement Terms, set out in Annex B of March 2009 Supplement, allow parties to voluntarily "compress" the physical settlement process for delivering loans<sup>20</sup>. If a loan must be delivered several times during physical settlement before reaching its final holder, the amendments allow the protection buyer that first transfers the loan to have the option, subject to necessary constraints, to skip the intermediate parties and deliver the loan directly to the ultimate protection seller. The intermediate parties will then settle their respective back-to-back trades through cash settlement.

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<sup>17</sup> Section 8.12 and definition of "Representative Auction-Settled Transaction" defined in Section 18 of the form of Credit Derivatives Auction Settlement Terms.

<sup>18</sup> In particular, please see the final two sentences of that definition.

<sup>19</sup> For example, if the APLMA publish template documentation facilitating the transfer of a Loan. This is particularly an issue when Delivery in part of a Loan is intended.

<sup>20</sup> See the definition of "Representative Auction-Settled Transaction" defined in Section 18 of the form of Credit Derivatives Auction Settlement Terms and in particular, limb (l)(vii) which amends Section 9.2(c)(iv) of the 2003 Definitions.

## *Miscellaneous - Initial Payment / Trade Date*

- 4.34 A new concept of Initial Payment has been inserted by the March 2009 Supplement to accommodate CDS market changes in standard terms, including upfront payments. Fixed Amounts remain unchanged. However, some new Transaction Types will have a set Fixed Rate and prescribed Fixed Dates and all Fixed Amounts will be full coupons with no short or long stubs. In this situation, an Initial Payment is made if the Effective Date is not one of the quarterly dates in respect of the coupon immediately prior to the Effective Date.
- 4.35 As a consequence of the amendments described above, references to Trade Date in definitions including but not limited to Grace Period, Not Subordinated, Restructuring, Substitute Reference Obligation, Deliverable Obligations characteristics, have been changed. Please see Schedule 2 to this opinion for further details.
- 4.36 Some less significant other changes are set out in Schedule 2 to this opinion. This is not a comprehensive list.

## **5 Key legal and regulatory issues arising under Credit Derivative Transactions**

- 5.1 Three particular legal and regulatory issues could arise under Credit Derivative Transactions when documented under the Credit Derivative Definitions<sup>21</sup>:
- (a) whether they constitute insurance contracts;
  - (b) whether they are derivatives under the Corporations Act; and
  - (c) whether they are gaming contracts.

### *Insurance*

#### *Summary*

- 5.2 In our view, most Credit Derivative Transactions entered into in accordance with the Credit Derivative Definitions should not constitute insurance under its common law definition assuming that the transaction terms and the intention of the Buyer and the Seller are consistent with the deemed agreement contained in Section 9.1(b)(i) of the Credit Derivative Definitions. This section provides that:

“the parties will be obligated to perform, subject to Section 3.1, in accordance with the Settlement Method or, if applicable in accordance with Section 12.1, Fallback Settlement Method applicable to such Credit Derivative Transaction, as applicable, irrespective of the existence or amount of the parties’ credit exposure to a Reference Entity, and Buyer need not suffer any loss nor provide evidence of any loss as a result of the occurrence of a Credit Event.”

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<sup>21</sup> These issues could also arise under the 1999 Definitions.

This is because at common law an intention to indemnify another for its loss is required to constitute an insurance contract. However, if the terms of a Credit Derivative Transaction or the parties' intention is inconsistent with this deemed agreement such that there is an intention for the Seller to indemnify the Buyer from loss then the Credit Derivative Transaction could be found to constitute insurance and the presence of Section 9.1(b)(i) should not be relied on to prevent this result in this circumstance.

### *Consequences*

5.3 The general<sup>22</sup> legal and regulatory consequences of a Credit Derivative Transaction constituting an insurance contract can be classified into three categories:

- (a) *Regulatory.* persons carrying on insurance business are required to be authorised under the *Insurance Act 1973 (Cth)*. If a Credit Derivative Transaction is an insurance contract and the Seller is not authorised to carry on an insurance business by the Australian Prudential Regulatory Authority under the *Insurance Act 1973 (Cth)* then the Seller could be liable for heavy fines<sup>23</sup>. In addition, the characterisation of a Credit Derivative Transaction as an insurance contract will affect its treatment as a financial product under Chapter 7 of the Corporations Act and the requirements of the Buyer and Seller to hold licences under the Corporations Act;
- (b) *Contractual.* The *Insurance Contracts Act 1984 (Cth)* imports terms into insurance contracts to which it applies, including the duty of "utmost good faith"(or "uberrimae fidei") on both parties<sup>24</sup>. If this duty applies, any party with knowledge of material facts not known to the other party is under a duty to make full disclosure of them. A failure to do so gives a right to damages, and a fraudulent failure by the Buyer to notify the Seller of such material facts makes the contract voidable<sup>25</sup>. If a Credit Derivative Transaction were to be an insurance contract, these terms would be included, which would not be consistent with a typical credit derivatives contract. In relation to unenforceability, unlike contracts of life insurance<sup>26</sup>, there is no statutory protection for contracts of general insurance transacted by unauthorised issuers. However, based on the principles from two decisions of the High Court of Australia<sup>27</sup> the stronger view would be that a Credit Derivative Transaction which is an insurance contract would not be rendered unenforceable merely because it

<sup>22</sup> There are other consequences which could arise with certain parties, for example Sellers who have restrictions on their powers may not have the power to issue insurance policies.

<sup>23</sup> The corporation is liable for up to 60 penalty units (this penalty can increase five fold if the corporation is convicted of such an offence by a court); officers are liable for up to 60 penalty units (*Insurance Act 1973 (Cth)* section 9 and section 10).

<sup>24</sup> *Insurance Contracts Act 1984 (Cth)* section 13, section 14

<sup>25</sup> *Insurance Contracts Act 1984 (Cth)* section 28. These remedies will not apply if the insurer would have entered the agreement on the same terms and conditions regardless of the insured's failure to disclose the relevant information.

<sup>26</sup> *Life Insurance Act 1995 (Cth)* section 230

<sup>27</sup> *Yango Pastoral Co Pty Ltd v First Chicago Australia Ltd (1978)* 139 CLR 410 and *Fitzgerald v F J Leonhardt Pty Ltd (1997)* 189 CLR 215

constituted an unauthorised insurance contract remain enforceable. However, we must point out that these cases do not involve insurance contracts and question of whether unauthorised insurance contracts are enforceable has yet to be considered by the courts of the Australian Jurisdictions. We also note that there may be adverse consequences on the enforceability of a Credit Derivative Transaction under Chapter 7 of the Corporations Act if the Seller is carrying on a business of issuing insurance contracts without an appropriate Australian Financial Services Licence; and

- (c) *Taxation.* Insurance contracts are subject to particular provisions of the various taxation and stamp duty laws of the Australian Jurisdictions, for example stamp duty may be payable on the amount which is regarded as the “premium.

### *Meaning of insurance*

- 5.4 The *Insurance Act 1973 (Cth)* and the *Insurance Contracts Act 1984 (Cth)* rely on the common law definition of insurance. The *Insurance Contracts Act 1984 (Cth)* purports to extend the definition<sup>28</sup>. However, even under the *Insurance Contract Act 1984*, there must still be provisions which pass the common law test before the contract will be taken to be a contract of insurance. We comment on the meaning of insurance for the purposes of Chapter 7 of the Corporations Act in paragraph 5.8 below.
- 5.5 Four elements must be present for a contract to satisfy the common law test of being an insurance policy:
  - (a) **Consideration.** This will usually be in the form of a premium. It need not be proportional to the risk undertaken<sup>29</sup>. The Fixed Amount could satisfy this requirement.
  - (b) **Benefit.** The occurrence of an event must result in a benefit being granted to the Buyer by the Seller. The concept of a benefit in the judgments is not limited merely to money<sup>30</sup>. However, a broad extension of the concept of a benefit to non-monetary benefits has been cautioned against<sup>31</sup>, and it would be reasonable to assume that benefits in non-monetary form should be limited to those which may be construed as being for money’s worth or as being paid for by the insurer or on the insured’s behalf. Thus an obligation on the Seller to purchase a Deliverable Obligation for its par price on the occurrence of a Credit Event may not qualify as a benefit, although a cash payment of the difference between the par and market value (such as the Cash Settlement Amount) would be considered a benefit.

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<sup>28</sup> *Insurance Contracts Act 1984 (Cth)* section 10(2): “a contract of insurance includes ...a contract that includes provisions of insurance in so far as those provisions are concerned although the contract would not ordinarily be regarded as a contract of insurance”

<sup>29</sup> *Australian Health Insurance Association v Esso Australia Pty Ltd (1993)* 116 ALR 253.

<sup>30</sup> *Medical Defence Union v Department of Trade* [1979] 2 WLR 686.

<sup>31</sup> See Megarry V.C. in *Medical Defence Union v Dept of Trade* [1979] 2 WLR 686.

- (c) **Uncertainty** as to whether the event will happen<sup>32</sup>. The fact that the Settlement Method need only be performed if the Conditions to Settlement are satisfied fulfils this requirement.
- (d) **An intention to ‘indemnify’**. Insurance contracts are indemnities for loss. In order to be construed as an indemnity the payment must “provide for the payment of a sum of money to meet a loss or detriment which will or may be suffered upon the happening of the event”<sup>33</sup>. Hence the obligation of the Seller must be dependent on the *loss* of the Buyer. If the obligation to pay is triggered by a Credit Event, which may or may not lead to a loss, then it is not an indemnity, and hence not an insurance contract.

There will not be an intention to indemnify if the obligation to pay by the Seller is independent of the actual loss suffered. For example, if the payout is quantified by reference to:

- a fixed value agreed<sup>34</sup> between the parties at the beginning of the transaction; or
- the difference between the market value of the underlying asset at the start of the transaction and its market value on the occurrence of the credit event,

then the payment is not contingent on the loss suffered by the Buyer and hence is not an indemnity. This is because in the above examples, if the Buyer is separately hedged against that risk, sells the underlying asset or has no exposure to the Reference Entity, they will still be entitled to recover under the contract despite not having incurred a loss<sup>35</sup>.

If the agreement is worded so that the payment by the Seller on a Credit Event is quantified by reference to the amount the Buyer does not receive following its enforcement against the Reference Entity, then the contract comes closer to being calculated on the Buyer’s “*loss*”, and not some objective “*value*”, and hence may be construed as an insurance contract.

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<sup>32</sup> *Prudential Insurance Co v Inland Revenue Commissioners* [1904] 2 KB 658 at 663 per Channell J

<sup>33</sup> *Prudential Insurance Co v Inland Revenue Commissioners* [1904] 2 KB 658 at 663

<sup>34</sup> While pre-agreed fixed payouts have been held to be insurance (for example *Maurice v Goldsborough Mort & Co* [1939] AC 452), it is still necessary that there be an intention to indemnify against loss. These cases were explained by the court in *British Traders Insurance v Monson* (1964) 111 CLR 86 on the basis that the assessment of the loss suffered by the insured merely proceeded on the basis of a pre-agreed valuation. The entitlement to payment only arose if loss occurred. This type of provision is common with marine and fire insurance contracts.

<sup>35</sup> Although some types of insurance that are not referable to the Buyer’s loss have been construed as an insurance contract (eg a life insurance contract - *Medical Defence Union v Dept of Trade* [1979] 2 WLR 686) they are limited to those cases where the loss is impossible to quantify, such as life, sickness and accident insurance policies.

The fact that the economic effect of the contract is similar to that of insurance is not enough to characterise the contract as insurance<sup>36</sup>. The court will not look to the underlying purpose of the contract, but rather on whether the obligation to pay is dependant on the loss as a matter of law.

Should the Buyer not be a creditor of, or have credit exposure to, the Reference Entity, clearly the contract will not be indemnifying the Buyer for loss and hence it will not be considered an insurance contract.<sup>37</sup>

## ***Derivative***

5.6 Section 761D(1) of the Corporations Act provides that:

“a *derivative* is an arrangement in relation to which the following conditions are satisfied:

- (a) under the arrangement, a party to the arrangement must, or may be required to, provide at some future time consideration of a particular kind or kinds to someone; and
- (b) that future time is not less than the number of days, prescribed by regulations made for the purposes of this paragraph, after the day on which the arrangement is entered into; and
- (c) the amount of the consideration, or the value of the arrangement, is ultimately determined, derived from or varies by reference to (wholly or in part) the value or amount of something else (of any nature whatsoever and whether or not deliverable), including, for example, one or more of the following:
  - (i) an asset;
  - (ii) a rate (including an interest rate or exchange rate);
  - (iii) an index; and
  - (iv) a commodity.”

5.7 A Credit Derivative Transaction satisfies this requirement provided that the Cash Settlement Date or the Delivery Date is in excess of the time prescribed for the purposes of section 761D(1)(b), currently 1 business day.

5.8 We note that the effect of section 764A(d) and section 761D(3)(c) is that contracts which amount to a “contract of insurance” as defined in Section 764A(2) of the Corporations Act are not derivatives for the purpose of Chapter 7. This definition of contract of insurance is inclusive of contracts “that would ordinarily be regarded as a contract of insurance even if

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<sup>36</sup> *Palette Shoes v Krohn* (1937) 58 CLR 1; *Lloyds & Scottish Finance v Cyril Lord Carpet Sales* [1992] BCLC 609.

<sup>37</sup> *Aon Financial Products Inc v Société Générale* (US Court of Appeals, Second Circuit, February 5 2007).

some of its provisions are not by way of insurance” and “a contract that includes provisions of insurance insofar as those provisions are concerned, even if the contract would not ordinarily be regarded as a contract of insurance”. Although there is no clear authority on this point, it is our view that this provision still requires a contract to have the constituent elements of insurance in order to be characterised as such (whether or not there are additional provisions of the contract which do not constitute insurance). As a result, a Credit Derivative Transaction which does not have the elements of insurance required under the common law discussed in paragraph 5.5 above, will not constitute a contract of insurance for the purposes of Chapter 7 of the Corporations Act.

### ***Gaming***

- 5.9 Section 1101I of the Corporations Act provides protection from gaming and wagering legislation for all ‘financial products’, not just certain types of ‘futures contracts’ as was previously the case.
- 5.10 This means that there is now a safe harbour from gaming and wagering legislation for all financial products. Credit Derivative Transactions have the benefit of the safe harbour because, as noted above, Credit Derivative Transactions are derivatives for the purposes of the Corporations Act, and are therefore also financial products.

## **6 Relationship-based legal issues under Credit Derivative Transactions**

- 6.1 In addition to the issue as to whether a Credit Derivative Transaction constitutes an insurance contract, there are a number of other regulatory or legal issues which could arise under Credit Derivative Transactions if there is a connection between the Reference Entity and the Buyer or between the Reference Entity and the Seller. As these depend on the nature of that connection, there is a range of possibilities. However, we set out below a brief description of the key issues of which we are aware may arise.

### *Confidentiality obligations owed to Reference Entity*

- 6.2 A relationship between the Buyer or Seller and the Reference Entity may give rise to a duty of confidentiality. This would arise, for example, if the Buyer were a bank and the Reference Entity were a customer of the Buyer. In circumstances where such a duty of confidentiality is owed, communication of the confidential information which arises from that relationship to the other party to the Credit Derivative Transaction could breach that duty. As such communication may occur on entry into a Credit Derivative Transaction, declaration of a Credit Event or settlement, it is important that participants analyse their confidentiality position with respect to the Reference Entity prior to entering into Credit Derivative Transactions.

### *Insider Trading*

- 6.3 The Corporations Act prohibits the entry into Credit Derivative Transactions by a person who is in possession of information which is not generally available and which, if it were generally available, would be expected by a reasonable person to have a material effect on

the price or value of the Credit Derivative Transaction<sup>38</sup>. This can potentially cause legal issues in connection with Credit Derivative Transactions, for example, where the Buyer has credit information on the Reference Entity obtained through a banking relationship with the Reference Entity. Again, the impact of these laws on each participant's position needs to be determined prior to entry into of Credit Derivative Transactions.

### *Defamation*

- 6.4 It could be argued that the publishing of pricing of credit protection against a Reference Entity is defamatory if it were to suggest that the Reference Entity is of a lower credit standing than it really is. A number of elements of such an action would need to be established and there are certain defences which might be available. However, in circumstances where a party is publishing statements on a Reference Entity's credit standing, advice should be taken on this issue.

### *Dealings with the Reference Entity*

- 6.5 Section 9.1(b)(iii) of the Credit Derivative Definitions provides that the parties may conduct any dealings with the Reference Entity as if the Credit Derivative Transaction had not been entered into and regardless of any adverse effect that such action may have on the other party's position under the Credit Derivative Transactions. It should be noted that the Corporations Act and the *Australian Securities and Investments Commission Act 2001 (Cth)* contain prohibitions on certain types of conduct which cannot be contracted out of.

### *Insolvency of Reference Entity where it is also the Seller*

- 6.6 Section 2.28 of the 1999 Definitions and Section 2.31 of the 2003 Definitions provide that a Credit Derivative Transaction is terminated if the Seller or the Reference Entity consolidates, amalgamates with, merges into or transfers substantially all of its assets to the other or if they become Affiliates of each other. However, this does not prohibit a Credit Derivative Transaction being entered into under which the Seller and the Reference Entity are the same legal entity. Such "self-referenced" Credit Derivative Transactions raise complicated issues of public policy and insolvency law in circumstances where the Seller/Reference Entity becomes insolvent<sup>39</sup>. It is possible that such transactions could be unenforceable on the Seller's insolvency and separate advice should be taken on these transactions.

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<sup>38</sup> This is not the only prohibition in connection with insider trading and credit derivative transactions. For example the communication of such information can also be prohibited.

<sup>39</sup> The issues are discussed in cases such as *Ex p Mackay, ex p Brown, re Jeavons* (1873) LR 8 Ch App 643 and *British Eagle International Airlines Ltd v Cie Nationale Air France* [1975] 2 All ER 390 and *International Air Transport Association v Ansett Australia Holdings Limited* [2008] HCA3; (2008) 234 CLR 151.

7 **Benefit**

This opinion is addressed to you personally and may not, without our prior written consent, be:

- (a) relied on by another person;
- (b) disclosed, except to members of the Australian Financial Markets Association, people who are subscribing to the Guide and persons who in the ordinary course of your or their business have access to your or their papers and records. Such disclosure is only made on the basis that such persons will make no further disclosure; and
- (c) filed with a government or other agency or quoted or referred to in a public document.

This opinion is strictly limited to the matters stated in it and does not apply by implication to other matters.

This opinion is given in respect of the laws of the Relevant Jurisdictions which are in force at 9.00 am local time on the date of this letter.

Yours faithfully

## SCHEDULE 1

Excerpt from Section 18 (*Definitions*) of Annex B (*Credit Derivatives Auction Settlement Terms*) to the March 2009 Supplement.

**"Auction Covered Transaction"** means a Covered Swaption Transaction or a Covered Non-Swaption Transaction, as applicable.

**"Bespoke Portfolio Transaction"** means a Credit Derivative Transaction that references more than one Reference Entity but that is not any type of Auction Covered Transaction (other than a Bespoke Portfolio Transaction).

**"Covered Non-Swaption Transaction"** means a Credit Derivative Transaction that is not an Excluded Index Transaction or an Excluded Non-Index Transaction, and for which:

- (a) the Affected Reference Entity is a Reference Entity;
- (b) "Auction Settlement" is the applicable Settlement Method;
- (c) an Event Determination Date has occurred with respect to the Affected Reference Entity on or prior to the Business Day immediately preceding the Auction Final Price Determination Date; and
- (d) the Deliverable Obligation Provisions are identical to one set of the Deliverable Obligation Terms determined by the relevant Convened DC to be applicable to the Auction.

**"Covered Portfolio Swaption"** means a Portfolio Swaption for which:

- (a) the Affected Reference Entity is a Reference Entity under the Underlying CDS;
- (b) "Auction Settlement" is the applicable Settlement Method under the Underlying CDS;
- (c) the Swaption Trade Date is on or prior to the Auction Final Price Determination Date;
- (d) the Expiration Date is after the Auction Final Price Determination Date; and
- (e) the Deliverable Obligation Provisions in the Underlying CDS are identical to one set of the Deliverable Obligation Terms determined by the relevant Convened DC to be applicable to the Auction.

**"Covered Single Name Swaption"** means a Single Name Swaption for which:

- (a) the Affected Reference Entity is a Reference Entity under the Underlying CDS;
- (b) "Auction Settlement" is the applicable Settlement Method under the Underlying CDS;
- (c) the Swaption Trade Date is on or prior to the Event Determination Date;
- (d) the Expiration Date is on or after the date of the occurrence of the relevant Credit Event as specified in the relevant Credit Event Resolution; and
- (e) the Deliverable Obligation Provisions in the Underlying CDS are identical to one set of the Deliverable Obligation Terms determined by the relevant Convened DC to be applicable to the Auction.

**"Covered Swaption Transaction"** means a Credit Derivative Transaction that is either a Covered Single Name Swaption or a Covered Portfolio Swaption, as applicable.

**"Deliverable Obligation Terms"** means any set of Deliverable Obligation Terms determined by the relevant Convened DC and set forth in Schedule 1 to these Credit Derivatives Auction Settlement Terms.

**"Excluded Index Transaction"** means any back-to-back Credit Derivative Transaction between any two of Citigroup Global Markets Limited, Credit Suisse First Boston International, Deutsche Bank AG, Goldman Sachs International, JP Morgan Chase Bank, Merrill Lynch International, Morgan Stanley Capital Services Inc. and UBS AG London Branch relating to trust certificates linked to any Dow Jones CDX.NA.HY Index or CDX.NA.HY Index.

**"Excluded Non-Index Transaction"** means (a) any Bespoke Portfolio Transaction (i) that references a portfolio of Reference Entities that is substantially identical to the relevant portfolio of Reference Entities for any series of credit linked notes, trust certificates or other similar instruments and (ii) the documentation for which expressly states that the final price is linked to such credit linked notes, trust certificates or other similar instruments, as applicable, (b) any Reference Obligation Only Transaction, (c) any Loan Only Transaction, (d) any Preferred CDS Transaction, (e) any Fixed Recovery Transaction and (f) any Credit Derivative Transaction that (i) by its terms expressly states that the provisions relating to settlement therein shall not be amended or modified by any Credit Derivatives Auction Settlement Terms or any documentation with respect to an auction published by ISDA and (ii) would, but for such express terms, be an Auction Covered Transaction.

**"Fixed Recovery Transaction"** means a Credit Derivative Transaction in respect of which the Final Price or final settlement amount is pre-determined and specified in the relevant documentation.

**"Loan Only Transaction"** means a Credit Derivative Transaction in respect of which "Loan" is specified as the only Deliverable Obligation Category or a Credit Derivative Transaction pursuant to which the Reference Obligations (which are required to be Loans) and certain other Loans (or Borrowed Money obligations other than Bonds) are the only Deliverable Obligations.

**"Portfolio Swaption"** means any unexercised option to enter into an Auction Covered Transaction (other than another Portfolio Swaption) that references more than one Reference Entity.

**"Preferred CDS Transaction"** means a Credit Derivative Transaction that references preferred securities or similar hybrid securities as Reference Obligations or Deliverable Obligations and which contains specific provisions pertaining thereto.

**"Reference Obligation Only Transaction"** means (a) a Credit Derivative Transaction in respect of which Physical Settlement is the applicable Settlement Method and "Reference Obligations Only" is specified as the Deliverable Obligation Category or (b) a Credit Derivative Transaction in respect of which Cash Settlement is the applicable Settlement Method and the relevant Confirmation specifies only one or more specifically identified Reference Obligations.

**"Single Name Swaption"** means any unexercised option to enter into an Auction Covered Transaction (other than another Single Name Swaption) that references not more than one Reference Entity.

**"Underlying CDS"** means, with respect to a Single Name Swaption or Portfolio Swaption, the underlying Credit Derivative Transaction to which the relevant option relates, provided that such underlying Credit Derivative Transaction is not an Excluded Index Transaction or an Excluded Non-Index Transaction.

## SCHEDULE 2

### Additional amendments made in the March 2009 Supplement<sup>40</sup>

- 1 There has been global change to the Definitions to amend methods of notice to now allow a notice to be in writing (including by facsimile and/or email) and/or by telephone.
- 2 There has also been a global change to the Definitions to amend references to Greenwich Mean time to include Tokyo Time if the related Reference Entity is Japan Corporate or Japan Sovereign.

#### Article I - General Definitions

- 3 Section 1.8 - The definition of Event Determination Date has been amended to incorporate new provisions dealing with Credit Event Notice, Credit Event Resolution Request Date and Event Determination Dates .
- 4 Section 1.9 - The definition of Notice Delivery period has been amended to mean the period from and including the Trade Date to the date fourteen days after the Extension Date. Should be read in connection with the new Section 1.25 - Extension Date.
- 5 Section 1.22 - “Credit Derivatives Determinations Committees” is a new definition which has been inserted describing the committees established by ISDA for purposes of reaching certain Determinations Committee Resolutions in connection with Credit Derivative Transactions. More fully described in Annexure A. A consequence of many of the functions of the Calculation Agent now being carried out by the Credit Derivatives Determinations Committees is that throughout the Definitions the word Determination has been replaced by Resolved. The definition of Resolve may be found in the new Section 1.28.
- 6 Section 1.23 - “Credit Event Backstop Date” is a new definition which describes the process for determining the date on which a Credit Event has occurred.
- 7 Section 1.24 - “Credit Event Resolution Request Date” describes the purpose of convening a Credit Derivatives Determinations Committee to Resolve whether an event constituting a Credit Event has occurred and the date of the occurrence of such event.
- 8 Section 1.25 - “Extension Date” means the latest of (a) the Scheduled Termination Date, (b) the Grace Period Extension Date and (c) the Repudiation/Moratorium Evaluation Date.
- 9 Section 1.26 - “Event Determination Date Conditions” means with respect to a Credit Derivative Transaction, the satisfaction of four conditions which relate to Auction Settlement, the timing of the Trade Date, the timing of the Credit Event Resolution Request Date and the announcement by ISDA of the Resolution by the relevant Credit Derivatives Determinations Committee of the occurrence of a Credit Event.

#### Article II - General Terms Relating to Credit Derivative Transactions

- 10 Section 2.2 - “Provisions for Determining a Successor” has been amended to incorporate the new role of Credit Derivatives Determinations Committees in determining whether thresholds have been met (2.2(a)(vi)). There are also changes to the meaning of Succession Event to include reference to Sovereign entities (2.2(b)). There are also changes to the definition of Sovereign Reference Entity and a description of the role of the Calculation Agent after a

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<sup>40</sup> This does not describe every change.

Credit Event (2.2(h)). Section 2.2(i) has been inserted to define a Succession Event Backstop Date and the role of the Credit Derivatives Determinations Committee in resolving that date. Section 2.2(j) defines the request made to ISDA that a Resolution be made on whether a Succession Event has occurred and the date of occurrence of such an event. Finally, 2.2(k) defines the mechanics of one party delivering a Notice of the occurrence of a Succession Event to the other party and the Calculation Agent.

- 11 Section 2.19 - "Method for determining an Obligation". Clause 2.19(b)(i)(A) has been amended to incorporate the notion of Prior Reference Obligation.

### **Article III - Conditions to Settlement**

- 12 Section 3.2 - "Conditions to Settlement" are satisfied by the occurrence of an Event Determination Date and the Section has also been amended to incorporate the new provisions in Article XII on Auction Settlement and the Fallback Settlement Method (3.2(a)). The provisions relating to Notice of Publicly Available Information is amended to incorporate new mechanics of Credit Derivatives Determinations Committee resolutions regarding Credit Events (3.2(b)). Finally section 3.2(c) which deals with Notice of Physical Settlement has been amended to incorporate the new provisions contained in Article XII and the addition of the Credit Derivatives Determinations Committee.
- 13 Section 3.3 - "Credit Event Notice" has been amended to remove details regarding Scheduled Termination Date, the Grace Period Extension Date and Repudiation/Moratorium which can now be found in different sections of the Definitions as discussed in this Schedule.
- 14 Section 3.4 - "Notice of Physical Settlement" has been amended to indicate the contents of a NOPS Amendment Notice which shall contain a revised detailed description of each replacement Deliverable Obligation that Buyer will Deliver to Seller and also specify the Outstanding Amount of each such Deliverable Obligation identified in the Notice of Physical Settlement or prior NOPS Amendment Notice.

### **Article IV - Credit Events**

- 15 Section 4.6 - "Repudiation/Moratorium" has been amended to enhance the requirements surrounding the Repudiation/Moratorium Extension Condition listed in Section 4.6(d) and to incorporate new provisions with Scheduled Termination Date and Credit Derivatives Determinations Committees.

### **Article V - Fixed Amounts**

- 16 Sections 5.5-5.8 have been inserted into the Definitions describing the Definition of Initial Payment and the process by which, if an Initial Payment Payer and an Initial Payment Amount are specified in the related Confirmation, the Initial Payment Payer will pay to the other party an amount equal to the Initial Payment Amount on the Initial Payment Date.

### **Article VI - General Terms to Settlement**

- 17 Section 6.4 - "Fallback Settlement Method" means, with respect to a Credit Derivative Transaction for which "Auction Settlement" is specified as the Settlement Method in the related Confirmation, if "Cash Settlement" is specified as the Fallback Settlement Method in the related Confirmation, Cash Settlement, otherwise Physical Settlement.
- 18 Section 6.5 - "Settlement Suspension" has been inserted to set out the role of ISDA and Credit Derivatives Determinations Committees in governing Settlement Suspension and roles of the various Parties during such a time.

### **Article VIII - Terms Relating to Physical Settlement**

- 19 Section 8.1 - “Physical Settlement” has been amended to include reference to the new NOPS Amendment Notices. 8.1(b) has been amended to reflect the amendments to Currency Amount in Section 8.9 and to include provisions relating to the Floating Rate Payer Calculation Amount.
- 20 Section 8.2 - “Deliver” has been amended to include references to the Credit Derivatives Determinations Committees and the documentation that will be required to be delivered by the Buyer and Seller to that Committee.
- 21 Sections 8.9 and 8.10- the definitions of “Currency Amount” and “Currency Rate have been amended to now be based upon either a Deliverable Obligation specified in a Notice of Physical Settlement or a Replacement Deliverable Obligation specified in a NOPS Amendment Notice. This change is also reflected in Sections 8.12-8.14.

### **Article IX - Additional Representations and Agreements of the Parties**

- 22 Section 9.1 - “Additional Representations and Agreements of the Parties” has been amended to include new sections dealing with the awareness of parties when entering into a transaction and that neither party is liable to the other (9.1(b)(vi) and (vii)). Section 9.1(c) has been inserted to address the role of Determinations Committee Party. 9.1(c)(i) addresses Determinations Committee Party liability, 9.1(c)(ii) indicates that Parties waive their claims against any Determinations Committee Party, 9.1(c)(iii) indicates that any Determinations Committee Resolution of a relevant Credit Derivatives Determinations Committee will be binding with exceptions to the binding nature of the definitions listed in 9.1(c)(iii)(A) and (B). Finally, 9.1(c)(iii)(C) and (D) list further conditions which Buyer and Seller agree to upon entering a transaction.

### **Article XI - Credit Derivative Physical Settlement Matrix**

- 23 Incorporates, in identical form, the provisions set out in the 2005 Matrix Supplement to the 2003 ISDA Credit Derivatives Definitions.

### **Article XII - Terms Relating to Auction Settlement**

- 24 Article XII - is a new section which introduces the Auction Settlement procedures to the definitions. Section 12.1 deals specifically with Auction Settlement while Section 12.7 provides a Definition of Credit Derivatives Auction Settlement Terms.

### **Annexure A - Credit Derivatives Determinations Committees Rules**

- 25 This is a new addition.

### **Annexure B - Form of Credit Derivatives Auction Settlement Terms**

- 26 This is a new addition.