

MALLESONS STEPHEN JAKUES

Australian Financial Markets Association
Level 3
95 Pitt Street
SYDNEY NSW 2001

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Scott Farrell
Partner
Direct line
+61 2 9296 2142

2009 ISDA Credit Derivatives Determinations Committees, Auction Settlement and Restructuring Supplement to the 2003 ISDA Credit Derivative Definitions

This advice is given on the 2009 ISDA Credit Derivatives Determinations Committees, Auction Settlement and Restructuring Supplement (“**July 2009 Supplement**”) to the 2003 ISDA Credit Derivative Definitions (“**2003 Definitions**”) published by the International Swaps and Derivatives Association, Inc. (“**ISDA**”). This advice supplements our earlier advice to you on the 2009 ISDA Credit Derivatives Determinations Committees and Auction Settlement Supplement (“**March 2009 Supplement**”) dated 3 April 2009 (“**April 2009 Opinion**”).

In this advice, we set out:

- the materials which we have reviewed;
- our opinion;
- the qualifications to which this opinion is subject; and
- a brief discussion of the key changes made by the March 2009 Supplement.

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 July 2009 Supplement. In essence the Protocol follows the Protocol which implemented the March 2009 Supplement on which we commented to you in our separate letter on the same date as the April 2009 Opinion.

1 Materials reviewed

1.1 We have reviewed the following documents published by ISDA:

- (a) the 2003 Definitions (as supplemented by the March 2009 Supplement); and
- (b) the July 2009 Supplement.

The 2003 Definitions, as supplemented by the July 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 **Opinion¹**
- The conclusions which we set out in our April 2009 Opinion would continue to apply if the 2003 Definitions are amended by the 2009 July Supplement.
- 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

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

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 In the March 2009 Supplement, the form of Credit Derivatives Auction Settlement Terms and Rules of the Determinations Committees were attached as Annexes A and B, respectively. The July 2009 Supplement² provides that the Rules and Credit Derivatives Auction Settlement Terms will be “*as published by ISDA on its website at www.isda.org (or any successor website thereto) from time to time and as amended from time to time*”. At the date of this opinion, the form of Credit Derivatives Auction Settlement Terms and Rules are not available on ISDA's website. Accordingly, we can not comment on these.
- 3.4 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.
- 3.5 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 July 2009 Supplement

Overview

- 4.1 The July 2009 Supplement applies Auction Settlement to Restructuring Credit Events specified as applicable in respect of Credit Derivative Transactions (“**Transactions**”).
- 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 July 2009 Supplement into the terms of those Transactions by adhering to the 2009 ISDA Credit Derivatives Determinations Committees, Auction Settlement and Restructuring CDS Protocol (the “**Protocol**”).

² Section 1.22 and Section 12.8.

- 4.3 Parties can also incorporate the July 2009 Supplement into their Transactions by expressly stating in the relevant Confirmation that the July 2009 Supplement applies.
- 4.4 The July 2009 Supplement implements the following:
- (a) amendments to Sections 2.32 and 2.33, specifically the definitions of Restructuring Maturity Limitation Date and Modified Restructuring Limitation Date;
 - (b) applies Auction Settlement to Restructuring Credit Event ("**Restructuring**");
 - (c) provides for multiple 'parallel' Auctions to be held for each Restructuring;
 - (d) amends the definition of an Event Determination Date;
 - (e) inserts a new definition of Exercise Cut-off Date;
 - (f) inserts a new definition of Movement Option;
 - (g) delineates Fallback Settlement Methods for Restructuring; and
 - (h) sets out a framework of procedures and timing for Restructuring Auctions.

Multiple Auctions and why these are required

- 4.5 The Auction process³ operates so that Participating Bidders in the Auction provide bids and offers in respect of a *single list of Deliverable Obligations*⁴ for the affected Reference Entity (the "**Affected Reference Entity**").
- 4.6 The elections of Restructuring Maturity Limitation and Fully Transferable Obligation ("**MOD R**")⁵ and Modified Restructuring Maturity Limitation and Conditional Transferable Obligation ("**MOD MOD R**")⁶ in Restructuring impose separate maturity limitations on the remaining term of the Deliverable Obligations which may be used to settle a Transaction.⁷

³ Which is described in the form of Credit Derivatives Auction Settlement Terms which previously were set out in Annex B of the March 2009 Supplement but as per Section 12.8 of the July 2009 Supplement, a form of these (and the Rules) will be published by ISDA on its website www.isda.org.

⁴ Now referred to in the Rules as the "Final List".

⁵ Section 2.32, commonly specified for North American Reference Entities. Prior to the July 2009 Supplement, Section 2.32 operated so that the Restructuring Maturity Limitation Date was the earlier of (a) 2.5 years following the Restructuring Date and (b) the latest final maturity date of any Restructured Bond or Loan. It could never be earlier than the Scheduled Termination Date.

⁶ Section 2.33, commonly specified for Australian[, New Zealand] and European Reference Entities. Prior to the July 2009 Supplement, Section 2.33 operated so that the Modified Restructuring Maturity Limitation Date was the later of (a) the Scheduled Termination Date and (b) either (i) 5 years following the Restructuring Date for Restructured Bond or Loan or (ii) 2.5 years following the Restructuring Date for all other Deliverable Obligations.

⁷ N.B. Please refer to our previous opinions on the 1999 Definitions, the 2003 Definitions and commentary on Sections 2.32 and 2.33 of the 2003 Definitions.

- 4.7 The elections of MOD R and MOD MOD R are *mutually exclusive*.⁸
- 4.8 Historically these elections were inserted to address the "*cheapest to deliver*" issue whereby a Buyer has an incentive to purchase the obligation of the Affected Reference Entity which is trading at the lowest price and deliver that obligation to the Seller in order to maximise its return under the Transaction. This occurs in respect of a Restructuring because the value of the obligations of the Affected Reference Entity may be widely divergent depending on the maturity of the obligations. The effect of the MOD R and MOD MOD R elections is to limit the maturities of Deliverable Obligations to a maturity range that does not extend for a significant period of time beyond the Term of the Transaction.⁹ A similar concern does not arise with most of the other Credit Events as their occurrence will usually be assumed to amount to an event of default under *all* the Affected Reference Entity's debt obligations.
- 4.9 The election of MOD R or MOD MOD R has the effect that different Deliverable Obligations are able to be used to physically settle Transactions in respect of the same Affected Reference Entity.
- 4.10 The July 2009 Supplement has amended Auction Settlement so that:
- (a) Auction Settlement applies to Restructuring¹⁰; and
 - (b) following a Restructuring, if an Auction is held in respect of an Affected Reference Entity¹¹, there may be *multiple Auctions* held for each Restructuring of that Affected Reference Entity with Transactions allocated to 'Maturity Buckets' by reference to the Scheduled Termination Date of each Transaction.

'Maturity Buckets'

- 4.11 The July 2009 Supplement amends **Sections 2.32 and 2.33** so that the definitions of Restructuring Maturity Limitation Date and Modified Restructuring Limitation Date are replaced with the concept of various '*Maturity Buckets*'¹² which each run from the Restructuring Date to their respective Limitation Date¹³ which can be the IMM Roll Dates¹⁴:
- (i) 2.5 years after the Restructuring Date, defined as the 2.5-year Limitation Date;

⁸ Please see the footnotes 20 and 21 of Exhibit A to the 2003 Definitions.

⁹ As per the Commentary on the May 11, 2001 Restructuring Supplement to the 1999 Definitions published by ISDA (publicly available on their website).

¹⁰ Section 12.1.

¹¹ N.B. 500/5 Criteria: we understand that ISDA's current intention is that an Auction will be compulsory for a Maturity Bucket where at least 500 Transactions are affected and 5 or more dealers are parties to those Transactions (otherwise the relevant Determinations Committee will determine whether an Auction will be held).

¹² This is not a defined term in the July 2009 Supplement.

¹³ Defined in a new Section 1.34.

¹⁴ the first of 20 March, 20 June, 20 September and 20 December in any year to occur.

- (ii) 5 years after the Restructuring Date, defined as the 5-year Limitation Date; and
 - (iii) 7.5 years, 10 years, 12.5 years, 15 years or 20 years after the Restructuring Date, defined as the 20-year Limitation Date.
- 4.12 The above amendments apply irrespective of whether a Determinations Committee determines that a Restructuring has occurred or an Auction will be held.
- 4.13 Following a Restructuring:
 - (a) each affected Transaction is automatically assigned to a '*Maturity Bucket*' by reference to its Scheduled Termination Date¹⁵;
 - (b) the relevant Determinations Committee will determine the Final List¹⁶ of Deliverable Obligations in respect of the Affected Reference Entity and announce the range of Scheduled Termination Dates applicable to each '*Maturity Bucket*' for which it will hold an Auction;
 - (c) the relevant Determinations Committee will publish Parallel Auction Settlement Terms¹⁷

Triggering

- 4.14 Unlike other Credit Events, an Event Determination Date ***does not occur automatically*** and a Notifying Party must¹⁸ trigger its Transaction in order for the Event Determination Date to occur.¹⁹
- 4.15 Once a Credit Event Notice is sent, if the relevant Determinations Committee determines that an Auction will be held, the common Event Determination Date will be the Credit Event Resolution Request Date.
- 4.16 The Credit Event Notice must be effectively delivered ***prior to*** the Exercise Cut-off Date.²⁰
- 4.17 Although not addressed in the July 2009 Supplement itself²¹, we understand that if the Seller triggers under these provisions, the affected Transaction will be assigned to the 30-year Maturity Bucket, regardless of the Scheduled Termination Date.

¹⁵ Subject to the Rounding Down Convention and the delivery of a CEN by the Seller.

¹⁶ Defined in Section 1.33 (and 3.3(a)(iii) (*The Final List of Deliverable Obligations*) of Annex A of the March 2009 Supplement)

¹⁷ Section 12.10.

¹⁸ Described as "*use it or lose it*" because after publication of the Final Lists of Deliverable Obligations, parties will have 5 Business Days to trigger affected Transactions.

¹⁹ Section 1.8(a)(ii)(A)(II), Section 1.8(a)(ii)(B)(II), Section 1.26(b) and Section 3.9.

²⁰ Section 1.26(b) for a Restructuring, Section 1.26(a) for non-Restructuring.

²¹ To be set out in the relevant Credit Derivatives Auction Settlement Terms on ISDA's website.

Movement Option

- 4.18 If a Transaction is assigned to a Maturity Bucket that the relevant Determinations Committee determines will not have an Auction, either:
- (a) the Buyer can move the Transaction down to the Maturity Bucket with the next earliest Maturity Bucket End Date that is having an Auction; or
 - (b) the Seller can move the Transaction to the 30-year Maturity Bucket if that Maturity Bucket is having an Auction.²²
- 4.19 The party, if any, that is first in time to exercise the Movement Option determines whether, and in which direction, the Transaction will move.
- 4.20 The Movement Option must be exercised within 4 Business Days following the Exercise Cut-off Date applicable to the Buyer.²³
- 4.21 If neither party exercises the Movement Option, the Transaction will not move and will be settled in accordance with the Fallback Settlement Method.

Fallback Settlement Method

- 4.22 If the Fallback Settlement Method applies to a Transaction, the only Deliverable Obligations that can be delivered are those Deliverable Obligations with a final maturity date on or prior to the Maturity Bucket End Date of the Maturity Bucket to which such Transaction is assigned.
- 4.23 If the relevant Determinations Committee has determined that one or more Auctions may be held, each Final List of Deliverable Obligations that is compiled will apply to the relevant Maturity Bucket, including a Maturity Bucket for which no Auction is held and for which the Fallback Settlement Method applies.
- 4.24 In all other relevant circumstances, Deliverable Obligations will be identified by reference to these terms.

Old Restructuring

- 4.25 If neither MOD nor MOD MOD R is applicable to a Restructuring, then Auction Settlement will apply in the same way as for other Credit Events.

Transactions not settled by Auction Settlement

- 4.26 Paragraph 4.9 of our April 2009 Opinion in respect of Transactions which are not settled by Auction Settlement remains the same to the extent that the relevant provisions of the Rules and form of Credit Derivatives Auction Settlement Terms annexed in the March 2009

²² New definition of Movement Option inserted in Section 12.17.

²³ Section 12.19

Supplement are not amended. In addition, the parties to a Transaction can incorporate the July 2009 Supplement but bilaterally agree to exclude the application of Auction Settlement in respect of that Transaction.

5 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

Additional amendments made in the July 2009 Supplement²⁴

Article I - General Definitions

- 6 Section 1.8 - The definition of Event Determination Date has been amended from the March 2009 Supplement to incorporate the new DC Credit Event Announcement provisions contained in Section 1.30 and 1.31. There have also been amendments to the mechanics surrounding Credit Event Restructuring.
- 7 Section 1.22 - “Credit Derivatives Determinations Committees” has been amended from the March 2009 Supplement to now publish the Credit Derivatives Determinations Committees Rules on the ISDA website rather than in Annexure A.
- 8 Section 1.23 - “Credit Event Backstop Date” has had minor amendments to the wording of the March 2009 Supplement.
- 9 Section 1.26 - “Exercise Cut-Off Date” amends the previous Section 1.26 (“Event Determination Date Conditions”) contained in the March 2009 Supplement to remove the Auction Settlement provisions and insert conditions surrounding whether a Credit Event is Restructuring or not Restructuring. Also, references to Trade Date are replaced with “Relevant City Business Day”, more specific timing is included and the concept of Final List incorporated into the Supplement.
- 10 Section 1.30 - “DC Credit Event Announcement” is a new section which adds the concept of the DC Credit Event Announcement to the Supplement. Under this new concept a public announcement is made by ISDA that the relevant Credit Derivatives Determinations Committee has Resolved that (a) a Credit Event has occurred, and (b) that such event has occurred after the Credit Event Backstop Date.
- 11 Section 1.31 “DC No Credit Announcement” follows on from the new Section 1.31 and is a public announcement by ISDA that the relevant Credit Derivatives Determinations Committee has resolved that the event that was the subject of the notice to ISDA did not constitute a Credit Event for purposes of the relevant Credit Derivative Transaction.
- 12 Section 1.32 - “Relevant City Business Day” is a new section which adds the concept of Relevant City Business Day to the Supplement.
- 13 Section 1.33 - “Final List” is a new section which adds the concept of a Final List of Deliverable Obligations to the Supplement.

Article II - General Terms Relating to Credit Derivative Transactions

- 14 Section 2.2 - “Provisions for Determining a Successor” has had minor amendments from the March 2009 Supplement.
- 15 Section 2.32 - “Restructuring Maturity Limitation and Fully Transferable Obligation” has been amended from the March 2009 Supplement to insert a new definition of Restructured Maturity Limitation Date.

²⁴ This does not describe every change.

- 16 Section 2.33 “Modified Restructuring Maturity Limitation and Conditionally Transferable Obligation” has been amended from the March 2009 Supplement to insert a new definition of Modified Restructuring Maturity Limitation Date.
- 17 Section 2.34 “General Terms Relating to Restructuring Maturity Limitation Date and Modified Restructuring Maturity Limitation Date” is a new section which has been added to the Supplement setting out definitions of “Enabling Obligation”, “Limitation Date”, “Restructured Bond or Loan” and “Restructuring Date”.

Article III - Conditions to Settlement

- 18 Section 3.2 - “Conditions to Settlement” is amended from the March 2009 Supplement to incorporate the new Credit Event Restructuring definitions contained in Section 1.30 and 1.31.
- 19 Section 3.4 - “Notice of Physical Settlement” has been amended from the March 2009 Supplement to incorporate Credit Event Restructuring.
- 20 Section 3.9 - “Credit Event Notice After Restructuring” has been amended from the March 2009 Supplement to set out the conditions by which a Notifying Party may deliver Credit Event Notices.

Article XII - Terms Relating to Auction Settlement

- 21 Article XII was a new Article in the March 2009 Supplement which set out the terms of Auction Settlement. New Sections have been added that set out Parallel Auction Settlement Terms (see Section 12.7, 12.10, 12.14, 12.15 and 12.16) and Transaction Auction Settlement Terms (Section 12.9). A new Section 12.17 (“Movement Option”) has been added which sets out the ability of parties to control the Parallel Auction Settlement Terms. Article XII has also been generally amended to incorporate the new Parallel Auction Settlement provisions.

Annexure A - Credit Event Notice and Notice of Publicly Available Information

- 22 Exhibit B (form of Credit Event Notice and Notice of Publicly Available Information) has been deleted and replaced with a new Exhibit B setting out a new form of Credit Event Notice and Notice of Publicly Available Information.

Annexure B - Notice of Physical Settlement

- 23 Exhibit C (form of Notice of Physical Settlement) is deleted and replaced with a new Exhibit C setting out a new form of Notice of Physical Settlement.

Annexure C - Notice to Exercise Movement Option

- 24 Exhibit G has been added to set out a form of Notice to Exercise Movement Option which incorporates the addition of the new clause 12.17.