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ALERT

JUNE 2019

Additional CDS Documentation Reforms On the Way

ISDA proposes "de facto" category of original issue indebtedness as part of its CDS definitional reforms.

On May 24, 2019, the International Swaps and Derivatives Association ("ISDA") published another credit default swap ("CDS") consultation ("May Consultation") proposing further changes to its 2014 Credit Derivatives Definitions ("Definitions") and Credit Derivatives Determinations Committees Rules ("DC Rules"). The amendments are incremental to, and would be implemented with, those proposed in ISDA's March 6 consultation ("March Consultation"*).* Collectively, the proposals are intended to address two strategies that were employed in the recent refinancing of Hovnanian Enterprises that the CFTC and ISDA's board found problematic: (i) an agreement to default on a debt payment (to cause a Credit Event) and (ii) the creation of original issue discount ("OID") debt (to alter CDS recoveries).

The proposals in the May Consultation exclusively address OID. Bonds and loans deliverable into CDS auctions ("Deliverable Obligations") are typically deliverable at their face amounts unless they have provisions regarding principal accretion. However, the concept of "Quantum of the Claim" in the Definitions requires the Outstanding Principal Balance ("OPB") to be determined in accordance with any applicable laws that would reduce or discount a claim to reflect the original issue price or accrued value of the obligation. The March Consultation sought to "clarify" that these "applicable laws" include insolvency laws even when the reference entity is not currently insolvent.

The May Consultation expands upon mandatory OPB discounting. Even in circumstances where "applicable laws" would not provide for a discount to par, Deliverable Obligations issued for less than 95 percent of face that do not specify an accretion mechanic would nevertheless be discounted from their maturity date on a straight-line basis under the concept of "Fallback Discounting."

The May Consultation also specifically addresses OID debt (like Hovnanian's) created through exchange offers involving multiple classes of debt, which can present difficulties in determining the "issue price." A change to the DC Rules would provide the authority and mechanics for DCs to resolve such issues, and a change to the Definitions would require Calculation Agents to follow any such DC guidance in determining OPBs.

If implemented, these changes would impact CDS on corporates and financials, but not sovereigns. ISDA seeks feedback by June 17.

We will continue to provide updates as further CDS reforms are proposed and implemented.

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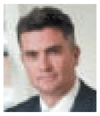

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