Lock-Up Agreements and CDS- Proposed Auction Solution

Summary: "Lock-Up Agreements" are market-wide arrangements, broadly standardized and predominantly integrated with court sanctioned restructuring or bankruptcy processes. Numerous end users will sign material Lock-Up Agreements prior to the default or restructuring of a Reference Entity. However, the amount of debt that is covered by Lock-Up Agreements can have a disproportionate impact on CDS settlement due to squeezes, perceived squeezes and the interplay of artificial and arbitrary factors such as auction timing and imprecise lock-up data.

The CDS industry represented by ISDA's Credit Steering Committee (CSC), aims to have a consistent and uniform approach in relation to Locked Up Debt and CDS Auctions that addresses the relevant issues.

The following proposal is a framework on which ISDA is seeking public comment and feedback. There are still operational points and other details that will be worked out if the feedback on the proposal is positive and that ISDA and the Credit Steering Committee should continue to develop the proposal. The proposal has been developed over the past several months in connection with issues relating to concerns regarding the effect of lock-up agreements on CDS settlement and is not intended as a response to any live DC Question. We note that adoption of any solution is solely a matter for the current CDS Determinations Committees.

We would appreciate any feedback on the proposal and whether you support moving forward with such a proposal

Proposed Solution:

Consistent with these aims, the following solution is being proposed by the CSC for implementation in CDS Auctions from the September 2025 roll .

- Auction dealers locked up/not locked up status will be communicated to relevant CDS market participants prior to the submission deadlines for any Auction to allow market order and limit order submitters maximum awareness and choice for submissions.[1]
- Market and limit orders will include a locked up/not locked up information submission by the submitter to ensure settlement efficiency. Any unmatched allocation of debt not subject to a lock-up would be done pro-rata through existing Auction infrastructure.
- Physical delivery of the debt will occur on a "pass through basis"[2] down the settlement chain meaning a Dealer is obligated to pass on what they receive. Where locked up debt reaches a break in the chain due to the pass-through participant choosing to remain unlocked, the remainder of the settlement chain will be cash settled (via a dealer poll). This is how Consent Required Loans are treated in CDS Auctions, in which the break in the

[1] We note that this will be communicated through existing Auction channels and will not be provided to the entire market.

[2] We note that timing requirements for pass-through will need to be developed, and welcome feedback regarding the timing requirements.

RAST chain for delivery of deliverable debt that cannot be accepted results in cash settlement.

<u>Scenario Examples:</u>

The following scenarios use the standard A-D Auction settlement chain.

- **A is not locked up, B is not locked up but C is locked up and D is not locked up.**
  - A (end user) delivers non locked up bonds to B (dealer), who delivers non-locked up bonds to C (dealer). Upon receipt by C, absent an exemption, such bonds become locked up. C cash settles with D (end user) by selling locked up bonds. Note that logically D would submit any limit or market order direct to B in this scenario.
- **A, B and C are locked up but D has decided to remain not locked up.**
  - A (end user, locked-up) delivers locked up bonds to B (dealer, locked-up), who passes through locked up bonds to C (dealer, locked-up), who cash settles with D (end user, not locked-up) by selling locked up bonds. Note that cash settlement would also occur higher up the chain if a pass-through dealer was not locked up.
- **A, B and C are not locked up but D is locked up.**
  - A (end user, not locked-up) delivers non locked up bonds to B (dealer, not locked-up), who passes through non locked up bonds to C (dealer, not locked-up), who passes through non locked up bonds to D (end user, locked up) at which point they become locked up by being held by D.
- **A, B, C and D are locked up.**
  - A (end user) delivers locked up bonds to B (dealer), who passes through locked up bonds to C (dealer), who passes through locked up bonds to D (end user).