

**Memorandum on CDS on German Banks – Proposed Changes in Documentation Practice**  
**(published on November 22, 2018)**

*This note has been prepared by ISDA’s Credit Steering Committee (the “CSC”) to explain the CSC’s recommendation for changes to documentation practice for CDS transactions referencing German banks. This note does not constitute legal advice to any interested person from ISDA or the CSC. Further, neither ISDA nor the CSC undertake any duty of care, nor shall they otherwise be liable, to any interested person.*

**Recent Change in German Bank Law – Implications for CDS**

- Historically, senior German bank debt did not distinguish between non-preferred and preferred senior debt. In 2015, by statute Germany made all senior bank debt subject to loss absorption, making it equivalent to senior non-preferred debt in other jurisdictions. For a period of time there was no framework for the issuance of senior preferred debt by German banks.
- From 21 July 2018, a change in law allows German banks to issue two types of senior unsecured debt obligations – senior preferred and senior non-preferred. This is similar to the position in other EU countries, for example equivalent French law for French banks.
- This law change confirms that senior debt obligations issued by German banks prior to 21 July 2018 rank *pari passu* with senior non-preferred debt obligations issued on or after 21 July 2018.
- As a result, CDS contracts on a German bank with a Reference Obligation (including a Standard Reference Obligation) where the Reference Obligation was issued either (a) prior to 21 July 2018 as a senior debt obligation or (b) on or after 21 July 2018 as a senior non-preferred debt obligation, are at the same level of seniority, which is senior non-preferred.

**Current Documentation Practice**

- With the advent of issuance of senior non-preferred debt by French and more recently Spanish banks, ISDA published new CDS provisions which were adopted for CDS on senior non-preferred debt of those banks.
- Because of the different approach adopted under German law described above, documentation of CDS on German senior bank debt continued on the same terms as had previously been used, with “Standard European Financial Corporate” as the Transaction Type. This is in contrast with documentation practice for CDS on e.g. French banks, which has been to use “Standard European Senior Non Preferred Financial Corporate” for transactions with a senior non-preferred Reference Obligation.

- The only difference between the two Transaction Types is that “Standard European Senior Non Preferred Financial Corporate” includes the Additional Provisions for Senior Non-Preferred Reference Obligations (published on December 8, 2017) (the “**Supplement**”). The Supplement explicitly recognizes three levels of seniority for Standard Reference Obligations (Senior, Senior Non-preferred and Subordinated), and so facilitates trading of CDS at three levels instead of two.

### **Proposed Documentation Practice Change**

- It is proposed that the trading convention for single-name and index CDS referencing a German bank at the senior non-preferred level and documented under the 2014 ISDA Credit Derivatives Definitions (the “**2014 Definitions**”) use the “Standard European Senior Non Preferred Financial Corporate” Transaction Type, from a future date to be agreed.
- This will recognize that German bank debt can now be issued at two senior levels, and allow firms to trade German bank CDS on both senior preferred and senior non-preferred.

### **Proposed Protocol For Legacy Transactions**

- For legacy single-name and index CDS transactions using the 2014 Definitions that reference German banks (other than subordinated CDS transactions), it is proposed to amend those transactions via an ISDA Protocol to change the Transaction Type from Standard European Financial Corporate to Standard European Senior Non Preferred Financial Corporate. The effect of this change will be to incorporate the Supplement.
- More specifically, in-scope trades for the Protocol would be such legacy transactions where either: (a) Standard Reference Obligation is applicable, except those transactions where the parties have indicated that the Seniority Level is “Subordinated”; or (b) a Reference Obligation is specified that was either (i) issued prior to 21 July 2018 as a senior debt obligation or (ii) issued on or after 21 July 2018 as a senior non-preferred debt obligation.
- This amendment will not change the seniority of the CDS, but it will ensure there is no documentation basis between legacy transactions and new transactions on Standard European Senior Non Preferred Financial Corporate once the documentation practice change takes effect.

### **Operational Implications**

- The changes described above may require systems changes for firms and market infrastructure providers in order to recognize that legacy and new senior non-preferred CDS transactions on German banks are fungible. ISDA will work with its Credit Implementation Group and infrastructure providers to identify changes and publish guidance as needed.