

**December 18, 2009**

**Small Bang Protocol: Credit Operations Best Practices**

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## **1. Introduction**

This is a best practice document detailing the workflow relating to restructuring credit events processed post the Small Bang (SB) on July 27, 2009. This is a tactical solution and will be updated with the introduction of a more automated strategic solution.

These tactical processes are to be implemented immediately, using the current Credit Event Processing Infrastructure.

Alternative information can be found on the ISDA and DTCC websites.

## **2. Determination of Restructuring Credit Event**

### **2.1 Request for “ruling”:**

Any firm may ask the DC to rule on whether a restructuring event has taken place. The EDD will be the actual date that the request was made to the Determinations Committee. All information on the ruling is available on the ISDA website. (<http://www.isda.org/credit/>)

### **2.2 DC ruling:**

A decision on whether a restructuring event has occurred may not be reached at the first meeting. However, until the determination has taken place, no action is taken (assume this is “D+0”).

Note: PAI is not needed as the event is already been “called”.

### **2.3 Trade compression**

It was agreed in the industry that a trade compression cycle on untranching index trades would be run prior to the reversioning of the index. This should be completed within a 3 day period. Subsequent compression runs on single names and tranche trades would be run on agreement in the industry.

### **2.4 DC reporting**

DTCC will report two different sets of data to the DC. First, there is the expectation that DTCC will need to report the “potential” number of trades, both single-name and index trades, which could be triggered. It is expected to do this in the first several business days (2-3) after “D”.

Secondly, the actual number of triggered trades will need to be reported. This will be a combination of those that are “noticed” through the DTCC platform and the trades that are reported as triggered (the two events mentioned i). As this requires the final bucketing information, which will typically be D+10 business days. Reporting will begin on the following day (may take until the second day to get the reporting complete) and each subsequent day up until the trigger end date.

This is important as the DC will use the combined totals of the legal triggers and non-legally binding notifications in DTCC to determine which auction buckets meet the minimum criteria to contain 300 triggered trades across 5 distinct DC members.

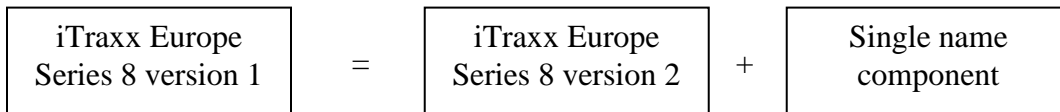
### 3. Reversioning and spin off of single name

Firms will need to un-adhere their affected index population of trades for clients that have not adhered to the Protocol and/or who have dis-applied the Small Bang at the time of trade. This population will also need to be removed from DTCC and reconfirmed on Paper – these trades are subject to Physical Settlement under the 2003 Definitions. This should be completed immediately after determination.

#### 3.1 Reversioning of index

**Markit split of indices:** If the name is in an untranched index that has restructuring (iTraxx or CDX.EM/EM Diversified), Markit will reversion the given index, taking out the component name.

For example:



The RED code information on this split may not be available until the next day (D+1 business days)

DTCC will create a credit event on the affected indices with the following attributes:

- event will be setup as auto-auto to ensure the greatest coverage
- Recovery will be set at 100% so that there will be no “loss amount”;
- The EDD in the system will be set to the last coupon roll date minus one day so there will be no partial coupon generated;
- RED code, reference entity name, annex date will be updated without moving cash;
- The future coupon will be adjusted as version 2 will have a factor of .992 (124/125ths);

Trades must be in “certain” status in the Warehouse to allow reversioning to take place.

- Tactical processing will take place on days to be specified by DTCC and CIG members. These dates are to be agreed on D+1 at the latest.
- During the DTCC reversioning of the index trades firms will have to confirm the spun off single name trades within a period specified for each event by a notice sent by the DC. . This will enable firms unconfirmed transactions to be auto auto processed after the initial D+1 process;

- Any reversioned index trades not reconfirmed after the last Auto Auto process will need to be bilaterally agreed;
- For the sake of clarity, if the DC determines that an event has occurred prior to 6.00pm on D+0, then D+1 will be then next business day. If the DC determination is after 6.00pm, the D+1 will roll to the 2<sup>nd</sup> business day (this is to ensure that Markit can reversion and publish the index in a timely fashion)

### **3.2 Single name spin off**

Firms are required to book and flow the “single-name” trades to DTCC. This contract must ‘mirror’ those of the original index transaction, with the exception of the notional which must be the notional of the component transaction.

The CIG have agreed that the following fields in the single name split must be confirmed as follows:

<b>Field</b>	<b>Value</b>
Trade date	Original index trade date,
Trade Date Exception	Trades resulting from Step-In assignments on the original index trade will be booked with a trade date of the <b>Latest Assignment trade date</b>
Effective Date	Original index effective date
Maturity Date	Original index maturity date
Fixed Rate	Original Index Fixed Rate
Notional	Component Notional in Original index trade (round to nearest unit)
Accrual commencement date	Previous coupon date (adjusted)
RED ID	Existing RED ID
First Payment date	Next IMM
Ref Ob	Current Red Preferred, if one does not exist, Ref Entity only
Master Document Type	Matrix or MCA - dependant on firms static*

\* If a firm is live on the Matrix then all transactions should be submitted under the relevant Matrix Type even if Trade date is prior to the firm’s Matrix go-live date.

## 4. Full Triggering – Legal notice

All Warehouse transactions which are to be fully triggered should take place using DTCC functionality, where possible. Any non Warehouse transaction will need to be triggered on paper. Reasons included:

- Need to consolidate the info for DC reporting;
- External audit trail; and
- Time is less of the essence as EDD goes back to the date of the request.

DTCC will create a “re-organisation” event in the TIW that will allow a triggering to serve as a true **IRREVOCABLE CEN**. (This event would have all of the legal significance of a CEN, including the inability to “un-adhere”. (Note: the DTCC spreadsheet upload will let you un-adhere during the tactical phase, but DTCC will create “audit reports” showing the adherence and ensure that the Operating Procedures cover the inapplicability of the un-adhere action<sup>1</sup>).

The terms in the published Protocol/Supplement indicate that the Seller can only trigger up to the first 2 (two) BD after the publication of the final list of deliverable obligations and the Buyer has the full 5 (five) BD to trigger. However, if the Seller and Buyer trigger up to the first 2 BD, the Seller trigger ‘trumps’ the Buyer trigger.

Please note that any triggers against a clearer (ICE / EUREX) must be done on paper as per their tactical proposal - please contact the clearer to provide further details.

### 4.1 Terminology

Triggers are unilateral and do not need acceptance by the receiving party. However, due to the nature of the “re-organisation” event in DTCC, triggers will use the “allege” and “unconfirmed” adherence terminology. It is unnecessary to confirm these triggers and if actioned in this way, it will adversely impact the bucket which the trade is placed in. Please see section 8.1 detailing how to un-adhere a credit event.

### 4.2 Recognition of triggering

There are 3 ways of identifying whether a trade has been triggered:

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<sup>1</sup> The DTCC Operating Procedures have been amended to record this ‘adherence’ as a legally binding, non-revocable CEN.

#### **4.2.1 Use of DTCC GUI**

It is possible to view the trigger status of each trade using the event processing GUI (further details can be provided in the DTCC guide)

#### **4.2.2 Restructuring Event Adherence Status Report (REAS)**

If a trade is triggered in DTCC, a REAS report will be produced at set times throughout the day. These will be available prior to the actual triggering period as it is possible to trigger at any point after the determination of the event and before the final list of deliverable obligations is published. Reports will only be produced if a trade has been triggered. Each report will replace the previous report from that day. (again further details can be provided in the DTCC guide)

#### **4.2.3 MQ messaging**

Firms can receive MQ messages from DTCC including all trigger information.

The TIW will record the adherence ie who triggered and when. This information can be used later to adhere the transactions to the correct buckets. (See section 8 on credit event calculations.)

#### **4.2.4 Paper triggers**

Paper triggers should be delivered for all non Warehouse transactions or for any partial triggers (please see section 4.3)



### ***4.3 Partial triggering***

In the tactical solution, it is not valid to partially trigger a trade in DTCC (as per the DTCC Operating Procedures). Any partial triggers in DTCC ie where a notional is submitted in the “new TRI” field will be deemed as invalid. All partial triggers must be submitted by paper CEN.

Partial triggers must agree to the following rules

- If the notional that is triggered is below the minimum, it will be assumed to be the minimum;
- Notional triggered must be in 1mm amounts (or integrals thereof) - (non adherence to this will result in trigger being invalid):
- If the notional that is triggered is above the last “known” notional (Warehouse current state notional), it will be assumed to be the previously agreed notional amount.

If a partial trigger is sent on paper, firms have agreed to take the following 2 actions:

1. Downsize the notional of the original trade to the triggered amount
2. Book a new trade (and flow to DTCC) to reflect the untriggered notional

For example:

- Trade123 – 10mm
- 6mm partially triggered
- Trade123 downsized to 6mm and fully settled. Trade456 created for 4mm and is UNTRIGGERED
- Trade456 later partially triggered by 3mm.
- Trade456 downsized to 3mm and fully settled. Trade789 created for 1mm and is UNTRIGGERED

All partial triggers **MUST** reference the original trade when the resulting trades are subsequently triggered

#### ***4.4 Notification of paper triggers***

In addition to serving as an electronic notification system, the TIW will be utilized to record the trigger information that is received in the paper world. This will be recorded as a separate “notify” event, but open at the same time as the ‘CEN’ event for several reasons:

- The seller may need to record the trigger so that DTCC can report on the triggered population if the buyer does not utilize the process (it will be difficult to require firms to use it). It will not count this as a seller trigger;
- Timing may become an issue if firms disagree about “first”. Therefore, this separate event will be used only to record information for consolidation purposes;
- The “new TRI” field on this notification event will be used to record if the paper notice was a triggering by the Buyer or the Seller
- **These trades will not be automatically adhered to the proper bucket credit event by DTCC (see below) as it is “second-hand” information.**

## 5. Movement Option

For transactions that have been triggered but for which there is NO auction, there will be a second decision period (3 days) where the following can happen:

- The buyer can elect to move down to the next lowest (in terms of maturity) bucket that has an auction. This can actually be one, two, or more buckets down the curve;
- The seller can elect to move to the 20+ year bucket if and only if there is a 20+ year auction. They cannot go to any other bucket;
- If no one elects this means the transaction goes to the fallback settlement method (physical settlement);
- The movement option can only be exercised for All or None of a single trade, there is no partial movement option.

Simple adherence to this event would indicate whether the buyer or seller elected the movement option.

The first party to exercise the option determines whether, and in which direction the transaction will move. However, a Buyer Movement Option will ‘trump’ a Seller Movement Option. Note: the time stamp is available on the Adherence Status by Trade report.

Firms may action the movement option via the DTCC event regardless of whether the trade was originally “triggered” via DTCC. Transactions which were originally triggered on paper but which have the movement option triggered via the warehouse will need to be manually adhered to the final auction credit event in the Warehouse to be processed by that event. Only one movement option should be needed.

Because this is an actual legal notice, this has been addressed in the TIW Operating Procedures.

## 6. Tranche processing

### 6.1 Key priorities:

- Retain both Triggered (Auction settled) & Untriggered Tranches in DTCC;
- Support post trade event processing on all tranches (triggered & untriggered) within DTCC;
- Retain cash settlement processing within TIW / CLS flow (see proposal below);
- Enable same Trigger DTCC triggering for Index Tranche.

This proposal is intended as a tactical solution which can not be sustained in the long term and is awaiting industry agreement on the strategic approach. As per section 3.1, tranching index trades are not reversioned but will be triggered as per any single name transactions.

### 6.2 Tranche Reversioning

- The rebooking and reversioning needs to be completed between the Movement Option End Date and the Auction Date;
- Firms will need to amend these transactions in their Risk systems and feed this information to DTCC as an amendment on the original transaction
- Untriggered Transactions will remain on their Original Version;
- Triggered Transactions will need to be booked to the relevant Bucket, depending on maturity ie:
  - Itraxx Europe Xover Series 10 Version 1 will need to be rebooked to possibly:
    - Itraxx Europe Xover Series 10a Version 1 – Tranche – 2.5yr bucket;
    - Itraxx Europe Xover Series 10b Version 1 – Tranche – 5yr bucket;
    - Itraxx Europe Xover Series 10c Version 1 – Tranche – 7.5yr bucket;
    - Itraxx Europe Xover Series 10d Version 1 – Tranche – 10yr bucket;
  - MarkIT will create new Index RED codes for each of the required Series, Versions and buckets.

### ***6.3 Tranche Auction Processing***

- Once the auction process has concluded and the recovery rates determined, on the cash settlement date as part of the DTCC event processing the tranche transactions can be reversioned onto the S2 version
- Using the example above, the rebooking will be completed as follows:
  - Itraxx Europe Xover Series 10a Version 1 – Tranche – 2.5yr bucket goes to Version 2;
  - Itraxx Europe Xover Series 10b Version 1 – Tranche – 5yr bucket goes to 2;
  - Itraxx Europe Xover Series 10c Version 1 – Tranche – 7.5yr bucket goes to 2;
  - Itraxx Europe Xover Series 10d Version 1 – Tranche – 10yr bucket goes to 2;
- The Recovery Rate will be published on the MarkIT website for each new RED ID for each Series, Version and Bucket;
- Once rebooked to the correct S2 version, Settlement will be able to be made through DTCC for both the Auction Settled Triggered and Untriggered Tranche transactions (those that remain on S1 V1 etc);
- For trades that are Physically Settled, either through the DC process or by the 2003 Definition Process, these trades will need to be bilaterally settled between the parties and REMOVED from DTCC.
- For trades removed from DTCC, reconfirmation of the transactions will need to be agreed bilaterally.

## **7. Credit event processing**

### **7.1 *Bucket adherence***

DTCC will automatically adhere all single name transactions to the appropriate bucket. However if there has been an error in the triggering process ie a counterparty has incorrectly “confirmed” the trigger in DTCC this will result in adherence to the incorrect bucket. It is possible therefore to action as follows to prevent incorrect processing

1. Gold no calc the trade – this unilateral action will ensure that DTCC do not perform event processing on this trade. This is only effective as a safeguard and the remaining steps must be completed.
2. Unadhere to the credit event once the auction bucket has been set up by DTCC and the triggered trades have been adhered.
3. Adhere the trade to the correct maturity bucket – this will need to be confirmed by the counterparty prior to Event Processing End Date

### **7.2 *Non tranche auction settled credit event calcs***

For transactions that have been triggered and are in a bucket with an auction (either naturally or as a result of the movement option), DTCC will perform the standard credit event calculations on these trades. As the triggered trades can only be single-name trades (or the split index single name trades that are reconfirmed as single name corporate trades), the process will work like a single-name trade including:

- Cancellation of next scheduled coupon;
- Calculation of partial accrual/rebate;
- Calculation of loss; and
- Exit of transaction.

The TIW will create a separate event for each auction bucket. For example, if there were auctions in the 2.5, 5, and 10 year buckets, the TIW would set up events called “Acme 2.5”, “Acme 5” and “Acme 10” year events.

Using the information from the legal notice triggered events, DTCC will semi-automatically adhere these trades to the correct credit event (via the DTCC Ops team). This decision will be based on:

- Which buckets have auction;
- Which party (buyer or seller) triggered the trade; and
- If either party exercised the movement option.

### ***7.3 Auction excluded triggered trades***

Trades that have been triggered but for which there was no auction in the original bucket and for which there was no movement option elected will need to be physically settled.

Firms will bilaterally:

- Leave the trades “live” in the Warehouse until they are settled (physical or cash) so that the trades can be margined and not created “gold” breaks;
- Settle the partial accruals/rebate;
- Settle the physical movement (or bilaterally agreed cash); and
- Exit the transaction

## **8. Old R Events**

### ***8.1 General Principles***

Old R or R Restructuring is market standard in the following transaction types:

Japan , Asia Ex Japan, Emerging Markets and Subordinated European Insurance

The processing of an Old R event will use the same infrastructure and processes as defined in this document previously, but an Old R event differs from the processing of maturity limitation restructuring (MMR or MR) events in the following ways:

1. Optional trade by trade triggering available from EDD date.
2. Credit Event Notice deadline is the Relevant City Business Day prior to the Auction Final Price Determination Date.
3. If there is no Auction Final Price Determination Date then trigger deadline is 21 calendar days after the no auction announcement
4. Buyer and Settler exercise notice period is the same
5. Only one auction/recovery rate (no maturity limitation)
6. As there is only one auction/recovery rate there is no need for a Movement Option
7. Full trade triggering only (not partial)

The standard process for Old Restructuring events would also involve a re-versioning of affected indices and booking of the spin-off component single name transaction.