

Summary of Report on the Function, Governance and Membership of the Credit Derivatives Determinations Committee (“DC Report”) and Market-Consultation

June 12, 2024



Agenda

Topics for Discussion:

- Importance of the DCs
- Summary of Linklaters LLP's independent report of the DCs and Changes for Consultation
- Next steps for ISDA (consultation and implementation)

The Importance of the Determinations Committees

- The CDS Determinations Committees (DCs) were established in 2009 with the encouragement of regulators to enable a standardized auction settlement process and ensure centralized clearing could be realized for Credit Default Swaps (CDS).
- The DCs and the auction settlement process provide a centralized means to determine whether a credit event has occurred, and the settlement value to be used for all cleared trades (regardless of the clearing venue) as well as non-cleared trades.
- The DCs were designed to produce quick decisions for the majority of credit event issues, with a fallback to an external review panel for those issues that are less easy to resolve (those where the DC cannot reach an 80% supermajority voting threshold).
- The DCs are comprised of five regional committees composed of up to ten voting dealers and five voting non-dealer members. There are also observer members, including the CCPs that clear CDS.
- DC decisions are published promptly by the DC Secretary on a public webpage devoted to activity of the DCs.
- The DCs are a critical piece of market infrastructure

Report Key Findings

- The report notes that there is a continued need for a centralized determination process for CDS, especially as the majority of CDS transactions are cleared.
- The report finds that, overall, the DCs have been functioning well, generally providing quick and accurate decisions.
- The report identifies several areas where improvements could be made to the current structure and governance of the DCs and provides recommendations to address these.
- The recommendations are grouped into key recommendations that should be the subject of the consultation and other more technical recommendations that could be considered separately.
- The key recommendations for consultation are set out below.

Report Key Findings: Potential for Conflicts of Interest

Issues

- The DCs comprise market participants that are expected to have CDS positions and therefore a financial interest in the matters they are deciding.
- There have always been protections in the DC Rules to mitigate the effect of potential conflicts of interest, but concerns in this area remain.
- It is not suggested that decisions have been influenced by conflicts but, if an issue were to arise in the future, this would have profound ramifications and so is an area of risk.

Proposed Solutions For Consultation

- An independent chairperson and up to two other independent members (with appropriate experience and status) join the DCs
- Enhance minimum requirements for DC members' compliance procedures
- Allow the DCs to refer decisions (especially difficult decisions) to an independent panel for resolution. This would be a more streamlined process for external review than currently exists.

Report Key Findings: DC Composition

Issues

- The number of firms willing to act as DC members has declined since the DCs were first put in place.

Proposed Solutions For Consultation

- Make it easier for buy-side firms to join the DCs by reducing the CDS portfolio size requirement and allow a buy-side firm to volunteer for individual jurisdictional DCs (rather than all or none as currently)
- Reflect the current levels of anticipated participation by reducing the number of positions available on the DCs.

Report Key Findings: Governance

Issues

- Only the DCs have the authority to amend the DC Rules. When the DCs consider potential rule changes, they must apply the same participation and confidentiality requirements that apply to DC decisions.
- This makes it difficult for market participants to have input into how the DCs operate

Proposed Solutions For Consultation

- Establishment of a governance body representing the main groups of market participants with responsibility for overseeing the way the DCs carry out their functions.
 - It would report periodically to the market and obtain feedback from market participants.
 - The governance body would have responsibility for making any changes to the DC Rules.

Report Key Findings: Representation and Transparency

Issues

- More transparency could be provided on some aspects of the DC process, such as publication of reasons why a DC decides not to deliberate a particular issue, and more consistent publication of reasons for decisions.
- The DC Rules do not provide a process for non-DC members to submit arguments in favor of a particular outcome

Proposed Solutions For Consultation

- The DC Rules should require reasons be given for all material decisions. The amount of detail required will depend on the decision.
- Within certain parameters, non-DC members should be able to advance arguments in favor of a particular outcome (although not necessarily anonymously).

Report Key Findings: Funding

Issues

- A new funding model is necessary to strengthen the long-term viability and robustness of the DCs.

Proposed Solutions For Consultation

- Seek views on the appropriate funding model for the DCs (in particular, whether a transaction-based levy of some sort would be acceptable)

Project Timeline and Next Steps

The project is being undertaken in three parts:

- **Q1 2024 - Independent Review:** In December 2023, ISDA commissioned outside counsel, Linklaters LLP, to interview market participants, regulators and academics and propose any potential changes to ensure the DCs' long-term viability. Linklaters' report was published on May 13, 2024.

Next Steps:

- **Q2 2024 - Public Consultation:** ISDA appointed Boston Consulting Group to conduct a consultation to determine which potential changes provided by the report have substantial support of the market.
 - The report and consultation can be found on ISDA's website here: <https://www.isda.org/2024/05/13/market-consultation-on-issues-and-solutions-from-the-independent-review-of-the-cds-determinations-committees/>
- **Q3 2024 – Q2 2025 (est) - Drafting and Implementing Changes:** Following the results of the consultation, ISDA will work with members to propose specific changes to implement any of the measures that receive broad public support. ISDA will then recommend these solutions to the DCs, which are solely responsible for agreeing and implementing any changes.

More Information

- Participate in the Consultation - <https://www.expandresearch.com/dc-review-consultation/>
- Independent Report of the DCs - <https://www.isda.org/a/IS1gE/DC-Review-Report-042924.pdf>
- Press Release - <https://www.isda.org/2024/05/13/isda-publishes-dc-review-and-launches-market-consultation/>

We encourage market participants to respond to the public consultation on the proposed DC rule changes. **The consultation will be open until July 26th.**