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Report

for the International Swaps and Derivatives Association, Inc.

on the Function, Governance and Membership of the Credit Derivatives Determinations Committees

Dated 29 April 2024

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1 Introduction

1.1 Scope

We have been retained by the International Swaps and Derivatives Association, Inc ("**ISDA**") to conduct an independent assessment of the function, governance and membership of the Credit Derivatives Determinations Committees (the "**DCs**"). We were asked not to review the substance of any decisions made by the DCs or to analyse or review the Auction (or any other settlement process) provided for by the Credit Derivatives Determinations Committee Rules (the "**DC Rules**") or the 2014 ISDA Credit Derivatives Definitions (the "**2014 Definitions**").

This Report sets out our independent assessment of the issues and solutions consulted on with the market participants listed in paragraph 1.2 below, together with the conclusions we have reached. The Report reflects our own professional views, which will not necessarily reflect those of any particular market participants (or any group of them).

We did not interview any individuals employed by ISDA for the purposes of this Report and the views and recommendations set out in it have been formed independently of any views that may be held by such individuals. Although we are being compensated by ISDA, our compensation is not contingent upon the views that we express or the content of our recommendations.

The proposals discussed in the Report (summarised in paragraph 15 below) are intended to be the subject of a wider consultation with market participants. ISDA has therefore not adopted, and is not recommending or otherwise endorsing, any of the recommendations in this Report. The action (if any) to be taken will depend on the results of that wider consultation.

1.2 Methodology

In December 2023, ISDA requested high level feedback from members of the DCs ("**DC Members**") and the Credit Steering Committee (a product steering committee established by ISDA) and general market participants pursuant to a press release[1], focussing in particular on the topics set out in Appendix 1 to this Report. Written feedback was obtained from nine organisations (one being a law firm representing certain buy-side organisations,[2] which provided consolidated feedback on behalf of the latter).

Following the receipt of this written feedback, we conducted a series of interviews with a range of market participants, including all the organisations that had provided written comments within the deadline set by ISDA. The interviewees comprised:

- seven sell-side DC Members;
- two buy-side DC Members;
- three sell-side firms which are not DC Members;
- the law firm representing certain buy-side firms which are not DC Members (one of which we also interviewed directly);

[1] https://www.isda.org/2023/12/14/isda-launches-independment-review-of-dc-process/

[2] Initially five buy-side firms were represented, although the group was subsequently expanded to seven.

- two central clearing counterparties ("**CCPs**"), namely LCH SA and ICE Clear Credit LLC;
- S&P Global Inc;
- the Depository Trust and Clearing Corporation;
- five regulators (in the US, the UK and internationally); and
- Allen & Overy, which represents the DC Secretary.

We also received written feedback from one sell-side DC Member after the deadline referred to above, together with comments from two lawyers with experience of CDS issues. Finally, we reviewed academic literature which commented on the DC structure and processes. The written and oral feedback was provided on a non-attributable basis and so we have not identified the organisation(s) which expressed any particular views.

The recommendations in this Report have been informed by the feedback we received. However, our comments are not solely a function of the number of views expressed in support of a particular approach. The discussion in this Report and the associated recommendations are also based on our own professional analysis of the issues (and our existing knowledge of the credit derivatives market).

2 Background

2.1 Rationale for the establishment of the DCs

A credit default swap (a "**CDS**") is a transaction under which one party (the "**Seller**") agrees to confer a financial benefit on the other party (the "**Buyer**") if it can be shown that an event satisfying certain criteria (a "**Credit Event**") has occurred in respect of a third party (the "**Reference Entity**"). The Credit Events are designed to identify situations in which there has been a significant deterioration in the creditworthiness of the Reference Entity. The criteria that must be satisfied for something to qualify as a Credit Event are set out in the 2014 Definitions, which constitute the standard documentation used in this area.[1] Although the 2014 Definitions contain a number of provisions which apply only if selected by the parties, certain standard elections are conventionally made. The conventions that apply depend on the type of Reference Entity in question (specifically, whether it is a corporate or a governmental entity) and the jurisdiction in which it is established.[2]

The financial benefit that the Seller confers on the Buyer following the occurrence of a Credit Event is intended to be a reflection of the extent to which the Reference Entity has suffered a deterioration in its creditworthiness. Until 2009, the convention was to use a physical settlement mechanism to achieve this.[3] It involved the Buyer selecting an obligation of the Reference Entity which satisfied certain criteria (a "**Deliverable Obligation**") and delivering that obligation to the Seller in return for payment by the Seller of the outstanding principal balance of the obligation. As the market value of the Reference Entity's obligations following a Credit Event is typically a fraction of their outstanding principal balance, this resulted in a net movement of value from the Seller to the Buyer which correlated with the extent of the credit impairment suffered by the Reference Entity.

The procedure that had to be followed during this period, if a Credit Event occurred, involved the Buyer giving certain notices to the Seller. Specifically, the Buyer delivered a notice specifying the Credit Event in question (a "**Credit Event Notice**"), a notice citing publicly available information which confirmed the occurrence of the Credit Event (a "**Notice of Publicly Available Information**") and a notice specifying the Deliverable Obligations that the Buyer intended to deliver to the Seller (a "**Notice of Physical Settlement**"). Settlement was required only if the appropriate notices had been given.

As the CDS market developed, it became apparent that these arrangements had a number of limitations. First, the requirement for notices to be given was operationally cumbersome, especially for entities with a large number of counterparties, and, if an error was made, the settlement process might not have been effectively triggered. Secondly, although many Credit Events are uncontentious, in some cases it may be a matter of debate whether a Credit Event has occurred. There may also be uncertainty about whether a particular obligation qualifies as a Deliverable Obligation. This sometimes resulted in Buyers challenging the Sellers' assertions and refusing to settle the transactions until the dispute had been resolved. Thirdly, many parties enter into transactions in respect of a particular

[1] Prior to the adoption of the 2014 Definitions, the 2003 ISDA Credit Derivatives Definitions were used. From 2009, the market convention was to use the latter in connection with a set of provisions (the 2009 ISDA Credit Derivatives Determinations Committees, Auction Settlement and Restructuring Supplement to the 2003 ISDA Credit Derivatives Definitions) which introduced the determinations and settlement process discussed in this Report, albeit with certain variations that are not material in the context of this Report.

[2] The standard elections are set out in the Credit Derivatives Physical Settlement Matrix.

[3] Although a number of ad hoc auction settlement protocols were developed following the occurrence of certain Credit Events in respect of specific Reference Entities.

Reference Entity as both Buyers and Sellers. Under a physical settlement arrangement, such parties would expect to use any Deliverable Obligations they receive in their capacity as Seller to settle transactions that they have entered into as a Buyer. All the outstanding transactions relating to that Reference Entity would therefore settle in parallel on the contractual settlement date. However, this process could be disrupted if one of the parties in the chain disputed the existence of a Credit Event. Such a dispute could have a knock-on effect on other transactions, potentially creating a systemic problem.

Finally, under a CDS it is not necessary for the Buyer to hold any obligations of the Reference Entity or, indeed, to have any other exposure to it. If a Buyer did not hold any Deliverable Obligations of the Reference Entity at the time that a Credit Event occurred, it would need to acquire them (typically by purchasing them in the market) in order to be able to deliver them to the Seller. In fact, even if the Buyer did hold such Deliverable Obligations, if others were trading at a lower value, it would normally be better for the Buyer to purchase those other Deliverable Obligations and deliver them to the Seller, while retaining (or selling) the more valuable obligations held by the Buyer. In practice, therefore, a uniform Deliverable Obligation was used for physical settlement purposes by all market participants, namely the one with the lowest market value (i.e. the cheapest to deliver).

One of the consequences of the fact that many CDS counterparties did not hold this Deliverable Obligation, however, was that, if a Credit Event occurred, there would sometimes be a spike in demand for the obligation. Inevitably, this pushed up its market price, effectively reducing the economic benefit that could be obtained from settling the CDS (sometimes significantly).

The DC process, and related measures, are designed to address these issues. There are five DCs, each with responsibility for a particular region.[1] The DCs are responsible for deciding certain matters referred to them, including (but not limited to) whether a Credit Event has occurred (although they retain a discretion whether to consider any request). A decision that there has been a Credit Event[2] (or that the relevant event does not constitute a Credit Event)[3] is binding on the parties to all transactions entered into on standard terms. This avoids any need for notices to be given under individual transactions and removes the risk of settlement being disrupted because different views are taken about the existence of a Credit Event.

A new settlement arrangement has also been introduced ("**Auction Settlement**"). If a Credit Event occurs, the relevant DC may decide to hold an auction in respect of various obligations of the relevant Reference Entity that the DC has determined to be Deliverable Obligations (an "**Auction**"). This is effectively a technique to determine the market value of the cheapest of those Deliverable Obligations while avoiding the result being artificially inflated by Buyers having to acquire the obligations for settlement purposes. A cash settlement amount is then payable by the Seller to the Buyer, determined by multiplying the notional amount of the transaction[4] by the difference between 100 per cent and the price determined in the Auction, expressed as a percentage.[5]

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1 Americas, Asia (excluding Japan), Australia/New Zealand, Europe/Middle East/Africa and Japan.

2 2014 Definitions, Section 1.28.

3 2014 Definitions, Section 1.29.

4 i.e. the Floating Rate Payer Calculation Amount.

5 2014 Definitions, Section 6.4.

2.2 Successors

Another type of decision that may be required is whether a corporate event in respect of a Reference Entity (such as a transfer of its business to one or more other entities) has resulted in there being one or more Successors to that Reference Entity, so that the CDS should be treated as relating to the Successor(s) instead of, or in addition to, the original Reference Entity. The 2014 Definitions set out certain tests for determining whether a Successor exists[1] and a DC may be asked to determine whether these tests are satisfied in respect of a Reference Entity.[2]

2.3 Initiating the determinations process

For an issue to be deliberated by a DC, a party to a credit derivative transaction that incorporates the 2014 Definitions (or certain predecessor documentation) or a relevant CCP that has an open interest in such a transaction (an "**Eligible Market Participant**") must make a request to the DC Secretary to this effect.[3] The request must also be accepted by a certain minimum number of DC Members.[4] If, in relation to a potential Credit Event, no such request is made or a request is not accepted, Buyers may seek to trigger settlement of the relevant transactions in the traditional way (i.e. by giving a Credit Event Notice and Notice of Publicly Available Information to the relevant Sellers, followed by a Notice of Physical Settlement). Such an approach may, for example, be adopted where transactions relating to the Reference Entity in question are not widely traded.

2.4 DC membership

There is a detailed process for selecting DC Members. However, the overall objective is to have a mix of dealers and non-dealers, together with certain CCPs (which are non-voting members of the DCs).

The dealers are broadly selected (from those willing to serve) by reference to CDS trading volumes.[5] For a non-dealer to be eligible, it must satisfy certain criteria, such as having at least US$1 billion of assets under management or being a party to at least US$1 billion notional amount of outstanding credit derivative transactions referencing a single Reference Entity.[6] Certain dealers and CCPs can join particular DCs. However, any non-dealer that is appointed becomes a member of all five DCs.

The DC Rules contemplate that there may be ten dealer and five non-dealer DC Members with voting rights but this target is not always achieved and there are currently only nine dealers (or eight in the case of the Australia and New Zealand DC) and three non-dealers on the DCs.

2.5 External Review

Certain DC decisions require a majority of at least 80 per cent of those participating in a binding vote (a "**Supermajority**"). If a Supermajority is not achieved, the DC Question is

1 2014 Definitions, Section 2.2.

2 DC Rules, Section 3.5.

3 DC Rules, Section 2.1(a).

4 DC Rules, Section 2.2(a).

5 DC Rules, Section 1.6(a).

6 DC Rules, Schedule 2.

referred to a panel of three independent individuals[1] with relevant experience ("**External Review**").[2] The External Review Panel considers written and oral representations in support of the respective positions and is required to reach a decision within a specific timetable.[3] Its decision is binding in the same way as a DC decision.

This procedure is designed to ensure that any DC decision has broad support amongst the DC Members and reduce the extent to which individual DC Members can improperly influence the proceedings. There have been four occasions on which it has been used in the past.

[1] Section 4.2(e) of the DC Rules states that a list of members of the pool of individuals who are eligible to serve on an External Review Panel must be maintained and reviewed annually. This annual review is not done in practice and we recommend that the DC Rules should be changed to reflect the current practice. We do not think an annual review of the pool members is essential.

[2] DC Rules, Section 4.2(c).

[3] If this cannot be achieved, a new External Review Panel must be selected: DC Rules, Section 4.6(h).

3 General observations

3.1 Need for a determinations process

There was universal support amongst our consultees for the existence of a process by which determinations which are binding on all market participants can be made about matters such as whether a Credit Event has occurred or a Reference Entity has a Successor. We share this view. The volume of transactions relating to certain Reference Entities is such that it is difficult to see how a bilateral settlement process in respect of them could operate effectively, especially as the vast majority of CDSs are cleared. Clearing arrangements depend on standardisation, of both the transaction terms and the manner of performance. The existence of some form of determinations process therefore contributes to market confidence and enhances market stability. Its absence would no doubt deter many investors from entering the market and so the existence of such a process indirectly enhances liquidity and reduces transaction costs.

This is not, of course, to say that the DC process that currently exists cannot be improved or even replaced by a different model. These are the questions that were discussed with our consultees and are explored in this Report. However, the starting point is that a determinations process of some sort is highly desirable.

3.2 Speed of determination

One of the main strengths of the DC process cited by consultees was the speed with which most issues ("**DC Questions**") are resolved. Over the last five years, there were 142 DC Questions. Approximately 20 per cent of them were answered within seven days and around 57 per cent were answered within 30 days. Many consultees stressed the importance of prompt resolution (albeit not at the expense of achieving the right answer). One of the reasons for this is that, especially where a Credit Event is alleged to have occurred, the market value of the transactions in question is likely to be very sensitive to emerging information (or even rumour). If the matter is resolved quickly, this should reduce the extent to which market participants are exposed to such volatility.

Not all DC Questions, however, are answered so quickly. There have been situations in which meetings of the relevant DC have been adjourned repeatedly and it has taken several months for the matter to be resolved. Although by the standards of traditional dispute resolution processes, such as arbitration or court proceedings, this would still count as a speedy result, a number of consultees criticised both the extent of the delays and the lack of information provided about the reasons for them.

3.3 Accuracy

There appears to be a broad consensus that, in general, the decisions reached by the DCs represent what most informed observers would regard as the right result. This observation needs to be qualified by the fact that nine of the consultees are DC Members, who might be expected to have that view, and some of the other consultees (such as the regulators) were not in a position to express a view. However, if there were a general feeling that the DCs often reach decisions that are difficult to support, we would expect this to have been revealed by the consultation. As noted in paragraph 9.2 below, there were some adverse comments about decision-making transparency but that is a separate point.

3.4 Lawyer-lead

A small number of consultees commented that the DC process is now "lawyer-dominated" and "bureaucratic". In contrast to the position when the DCs were first established, the individuals who attend meetings are invariably lawyers. This is primarily due to the need to manage conflicts of interest, as discussed in paragraph 4.2.3 below. However, it was suggested that one of the side effects is that the DC representatives now adopt an approach which is "legalistic", rather than giving primacy to the underlying commercial objectives of a CDS.

It is fair to say that this point was not strongly pressed and, indeed, the majority of consultees disagreed with it. However, to the extent that it is viewed as a weakness, we disagree. Although the DCs do take decisions that have a non-legal element, the two most important categories of decision are whether a Credit Event has occurred (a "**DC Credit Event Question**") and whether a Successor to a Reference Entity exists. In each case, the process involves (a) determining the relevant facts, (b) interpreting the relevant provisions of the 2014 Definitions and (c) applying the 2014 Definitions, as so interpreted, to the facts that have been established. Each of these elements (in particular, the interpretation of the 2014 Definitions) involves a legal exercise. In our view, the exercise is therefore best carried out by lawyers.

Although interpretation involves applying the principles of construction under the governing law of the transactions under consideration to the provisions in question, it is important to emphasise that this does not mean that a purely textual analysis is required or, still less, that the 2014 Definitions must be interpreted literally. The factual background and the commercial purpose of the relevant provisions have a role (and sometimes an important role) to play. For example, under English law, although close attention must be paid to the language used,[1] individual provisions must be considered in the context of the 2014 Definitions as a whole and in the light of any background information (such as market practice) that could reasonably be expected to be common knowledge amongst users of the 2014 Definitions.[2] Furthermore, if there are two possible constructions, the DC is entitled to prefer the construction which is consistent with business common sense and reject the other.[3] This involves striking a balance between the indications given by the language and the implications of the competing constructions. In other words, it is an iterative process by which each suggested interpretation is checked against the provisions of the contract and its commercial consequences are investigated.[4]

That said, the subjective intention of the draftsman, or any drafting committee, cannot be taken into account and there are limits to the extent to which reliance can be placed on business common sense. As Lord Neuberger pointed out in *Arnold v Britton*:[5]

> "The exercise of interpreting a provision involves identifying what the parties meant through the eyes of a reasonable reader, and, save perhaps in a very unusual case, that meaning is most obviously to be gleaned from the language of the provision. Unlike commercial common sense and the surrounding circumstances, the parties have control over the language they use in a contract. And, again save perhaps in a

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1 *Re Lehman Brothers International (Europe) (No 8)* [2017] 2 All E.R. (Comm) 275 at [48].

2 ibid.

3 *Rainy Sky SA v Kookmin Bank* [2011] 1 WLR 2900 at [21].

4 *Wood v Capita Insurance Services Ltd* [2017] AC 1173, at [12].

5 [2015] AC 1619 at [17].

> very unusual case, the parties must have been specifically focussing on the issue covered by the provision when agreeing the wording of that provision."

New York courts adopt a similar approach. The Court of Appeals of New York set out a classic summary of contract interpretation, and the use of extrinsic evidence, in *Collender v. Dinsmore*:[1]

> "Custom and usage is resorted to only to ascertain and explain the meaning and intention of the parties to a contract when the same could not be ascertained without extrinsic evidence, but never to contravene the express stipulations; and if there is no uncertainty as to the terms of a contract, usage cannot be proved to contradict or qualify its provisions. In matters as to which a contract is silent, custom and usage may be resorted to for the purpose of annexing incidents to it. But the incident sought to be imported into the contract must not be inconsistent with its express terms or any necessary implication from those terms. Usage is sometimes admissible to add to or explain, but never to vary or contradict, either expressly or by implication, the terms of a written instrument, or the fair and legal import of a contract."

In theory, it would be possible for the DC Rules to provide for a wider range of considerations to be taken into account (at least if the 2014 Definitions were amended to permit this). For example, the DC could be allowed to take account of "market expectations", the "best interests of the credit derivatives market" or "how the product is supposed to work". However, in our view, it would be undesirable to do so. It would necessarily mean that, even though an objective reader of the 2014 Definitions, with an understanding of the commercial purpose of the provisions and all relevant background information, would understand the 2014 Definitions to mean one thing, the DC could decide that, having regard to wider considerations, they should be treated as meaning something else. Furthermore, it is difficult to see how any such additional considerations could be formulated other than by using quite nebulous concepts. The result would be a lack of predictability and the risk of decisions being taken that are difficult to justify objectively.

It should also be borne in mind that the fact that no Credit Event is found to have occurred even if there has been an observable deterioration in the creditworthiness of the Reference Entity does not necessarily mean that the DC process is flawed in some way. First, the Credit Events involve the application of a series of specific tests and the fact that the Reference Entity's credit is impaired does not necessarily mean that those tests are satisfied. For example, there may be a widespread expectation that a Reference Entity will enter into some form of insolvency proceeding in the near future. If the proceeding has not been initiated, there may be no Bankruptcy Credit Event – the possibility of future insolvency proceedings does not mean that the Reference Entity is *currently* insolvent. Secondly, the DC is required to make its determinations on the basis of information that is either public or can be published on the DC website[2] ("**Eligible Information**").[3] This is consistent with the position where CDS transactions settle bilaterally, when a Notice of Publicly Available Information must be given.

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1 55 N.Y. 200, 208-09 (1873) (citations omitted); *see also W.W.W. Assocs., Inc. v. Giancontieri*, 77 N.Y.2d 157, 162 (1990) ("A familiar and eminently sensible proposition of law is that, when parties set down their agreement in a clear, complete document, their writing should as a rule be enforced according to its terms. Evidence outside the four corners of the document as to what was really intended but unstated or misstated is generally inadmissible to add to or vary the writing" (citations omitted).).

2 DC Rules, Section 2.5(b).

3 2014 Definitions, Section 2.3.

It follows that a Credit Event may have occurred and yet there may be insufficient Eligible Information available to prove this.

In each of these cases, the absence of a finding that a Credit Event has occurred is a consequence of decisions taken in the drafting of the 2014 Definitions (i.e. the tests that have to be satisfied and the decision to exclude private information). Views may differ about whether these are the right decisions but they are not a reflection of the DC process.

We therefore reject the argument that one of the weaknesses of the DC process is that it is comprised of lawyers. Indeed, insofar as it relates to DC Credit Event Questions and questions about Successors, we regard this as one of its strengths. As regards the criticism that the DC is bureaucratic, it is important for there to be procedural rules and that the rules are followed in practice. However, we do think there is some substance in the criticism that the procedural requirements could be improved in certain respects. This is discussed further below.

From time to time, the DCs do take decisions that are not primarily legal in nature. For example, if they decide that a Credit Event has occurred, they must decide whether to hold an Auction.[1] If they do, the terms of the Auction must be determined.[2] These are not legal matters and so the individuals who take the decision will need to consider feedback from market experts. However, the issues tend to be relatively uncontroversial and none of our consultees suggested that any concerns arise from the fact that the decision-makers are lawyers.

[1] DC Rules, Section 3.2(a).

[2] DC Rules, Section 3.3(b)–(e).

4 Composition of the DCs

4.1 Introduction

One of the questions we have been asked to consider is whether the current composition of the DCs still provides the optimal structure for accomplishing the objectives of the DCs. We have also been asked to consider whether another decision-making process should be considered.

4.2 Issues

4.2.1 Decreasing engagement

It is apparent that there is less appetite on the part of both sell-side and buy-side market participants to become DC Members. Although the DC Rules contemplate that there will be up to ten sell-side DC Members and up to five buy-side DC Members, as noted above, there are currently only nine (or eight in the case of the Australia and New Zealand DC) sell-side and three buy-side DC Members (along with two non-voting CCP members). Several dealers that were formerly DC Members have decided not to continue their involvement.

It is difficult to pinpoint the reason for this decrease in engagement but there appear to be several factors at play. First, DC membership requires a significant commitment of resources, which often have to be deployed at short notice. Secondly, the procedures that need to be put in place to manage conflicts of interest (discussed in paragraph 5.1 below) add to the complexity of the resource-management process, particularly in the case of buy-side entities, which will often have smaller legal departments. Thirdly, there is a concern on the part of some DC Members about the legal and reputational risk associated with this function. Although the risk of being held liable for DC decisions may be limited, the prospect of being drawn into litigation or a regulatory investigation is unattractive, even if the DC is ultimately vindicated. Finally, as far as dealers are concerned, there is a significant cost associated with DC membership (although this is probably the least of the concerns as none of the DC Members we spoke to identified it as a major obstacle).

4.2.2 Impact of concerns about risk

Despite the observations made in paragraph 4.2.1 above, most of the existing DC Members remain committed to the DC as they see it as a type of public service, providing essential support to the credit derivatives market. The concerns mentioned above about the risk of litigation or a regulatory investigation do, however, appear to weigh on the minds of a number of DC Members.

Several consultees said that they thought that, to varying degrees, this has led DC Members to be somewhat conservative when drawing conclusions of fact from the available evidence or, in some circumstances, interpreting the 2014 Definitions. It was also suggested that there is a reluctance on the part of DC Members to cast a minority vote. It is said that, on occasions when this has been done in the past, the DC Members in question have been criticised by other market participants, or even accused of being improperly influenced by their own economic interests.

We have no reason to believe that concerns about risk have affected the decisions reached by the DCs. For example, it has not been suggested that any DC Member has voted with the majority despite holding the opposite view. It is also the case that

many DC Questions are straightforward and, for those, a unanimous decision is to be expected. However, at a minimum, a desire to achieve unanimity adds to the length of the decision-making process, at least where the issues are complex.

Where a decision involves evenly balanced arguments, it is to be expected that different DC Members may have different views. A minority view is not necessarily less valid than the majority view and certainly does not imply any impropriety. However, if the reasons for the minority, as well as the majority, view are clearly articulated (as discussed further in paragraph 9.2 below), this should help market participants to appreciate that the existence of alternative views may be legitimate.

4.2.3 Conflicts of interest

One of the potential drawbacks of the existing DC structure is that DC Members will often have CDS positions and, therefore, a financial interest in the matters they are deciding. This has led to concerns being expressed that the decision-makers will be improperly influenced by this, whether deliberately or as a result of unconscious bias. Hence, it has been suggested that:

> "the design of the DC mechanism manifests an obvious and potentially fatal structural flaw. Specifically, it fails to acknowledge or adequately constrain the acute conflicts of interest generated by the fact that DC members are permitted to wear two hats: one as a major contractual counterparty, the other as an adjudicator of issues which determine the payoffs under the very same contracts… This raises the prospect that – rather than making determinations as a neutral and independent referee – DC members will vote in their self-interest on the basis of their current exposures. Put simply, dealers might 'vote their book'. It also opens the door to collusion amongst DC members looking to secure an outcome in connection with one determination in exchange for future reciprocity".[1]

In response to criticisms such as this, in January 2016 the DC Rules were changed so as to require DC Members to enter into an agreement with the DC Secretary containing certain representations relating to (amongst other things) the management of conflicts of interest (see paragraph 5.1 below).[2]

Despite these changes, concerns appear to remain that voting on the DC may be influenced, to some degree, by the DC Members' economic positions. One consultee said to us that this view is "relatively widely held, including by people who used to be on the distressed debt desks of the banks". The individual who made this comment considered that the perception is probably wrong but thought that it undermines confidence in the CDS market and deters some investors from participating in it.

Although the DC Members to which we spoke expressed confidence in both their own procedures and those of other DC Members, the concerns that have been expressed should not be discounted. They are a fundamental consideration because confidence in the DCs rests not only in DC Members making determinations without regard to their own interests but also being seen to act in this way. The market must have confidence in the assertion that financial interests have no role in decision-

[1] Dan Awrey, *The Limits of Private Ordering Within Modern Financial Markets*, (2015) 34:1 Review of Banking and Financial Law 183–255.

[2] DC Rules, Section 1.8(b).

making. It is not enough to say (even with justification) that the right decisions have been taken.

This is also one of the issues to which the regulators are most alive. While recognising the benefits of the DC process, most of the regulators we spoke to identified it as their primary concern in relation to the DCs. They emphasised that the fact that there has been no regulatory intervention to date should not be taken to imply that they are happy with the status quo.

In our opinion, it is this aspect of the DC process that presents the greatest risk. If there were a serious breach of the required standards, this could lead to a collapse in market confidence and/or regulatory intervention, requiring immediate remedial action. This would undoubtedly have serious repercussions for the credit derivatives market.

For completeness, we would also make the point that the issue cannot be addressed merely by having greater buy-side representation on the DC. Buy-side DC Members may also have market positions (and, indeed, they are more likely to have directional positions than dealers). It therefore cannot be assumed that buy-side DC Members will act as a natural counter-balance to the sell-side.

In the discussion below, we consider various models that could be adopted to improve the protections in this area. In summary, they are (a) the appointment of independent DC Members (with votes), alongside the existing DC Members, (b) permitting the DCs to refer decisions to a separate independent panel or (c) replacing the DCs with such an independent panel, at least for certain types of decision.

An alternative approach would be to make none of these changes but merely enhance the protections provided in the DC Rules against conflicts of interest. This alternative is considered in paragraph 5 below.

4.3 Independent DC Members

The first model would involve appointing as DC Members one or more individuals who are not affiliated with any organisation that has CDS positions. Each such individual would have a vote and, for the reasons set out in paragraph 3.4 above, would be legally qualified. Ideally, they would have experience of derivatives or, at least, the financial markets. A suitable appointee might, for example, be a retired judge. We think an ideal number would be three such individuals as this would enable them to block a Supermajority (if they all voted together). It would also ensure that there is at least some independent DC representation if one or two of them were unavailable. However, if, in practice, the more difficult questions are referred to an independent panel (as discussed in paragraph 4.4 below), one or two independent DC Members may be sufficient.

We also think it would be desirable for one of the independent members to chair DC meetings. At present, meetings are chaired by the DC Secretary or its legal advisers, which is not ideal, given that they report to the DCs. An individual such as a retired judge is likely to be skilled in this area and would, we think, add credibility as a figurehead of the DCs.

We do not think it would be difficult to find highly qualified legal professionals who are prepared to fulfil this role,[1] especially in the UK (where the most complex issues tend to be

[1] For example, PRIME Finance has published a list of individuals with legal expertise and experience of the financial markets, broken down by jurisdiction.

considered).[1] It may be more difficult to ensure that they are all available at short notice but, as mentioned above, if there were a number of independent DC Members, this may not be problematic.

We floated this proposal with our consultees. Most of them indicated that they are not averse to the idea. Potential objections were a fear that the independent representatives might be "bamboozled" or (to the contrary) that they might have a disproportionate influence as other DC Members may be too deferential to them. However, in our view, neither of these concerns is likely to arise, especially in the case of a retired judge (who will have experience of assimilating complex information and listening to alternative views). In fact, we think that having lawyers with a diverse range of experience on the DCs would improve decision-making. For example, a former commercial court judge would have extensive experience of interpreting contracts and deciding facts on the basis of the evidence available, while other DC Members would contribute a knowledge of the market that such an individual may lack.

We also think that concerns about risk are likely to weigh less heavily on independent DC Members. They would have no need for information barriers or complex compliance procedures and would receive less regulatory scrutiny. Although the risk of litigation would remain, such risk is a normal incident of professional practice and would be covered by professional indemnity insurance.

Another concern that was expressed is that the proposal is likely to be expensive. There is no doubt that it would require some additional funding. However, for the reasons set out in paragraph 12 below, an alternative funding model would be highly desirable anyway and, as we have already indicated, the total cost of the DC process does not appear to be a primary concern. In any event, the extra costs are likely to be relatively modest in the context of the total cost of the DC process.

4.4 Independent panel

4.4.1 Discretion to refer questions

Another model (which could be in addition to having independent DC Members) would involve establishing a separate panel of independent lawyers to which questions about Credit Events and Successors could be referred by the DCs. Questions could be referred either because there is uncertainty about the interpretation of the 2014 Definitions or because it is unclear what findings of fact should be made on the basis of the evidence presented. A simple majority of the DC should be sufficient for any such referral. A decision made by the panel would be binding in the same way that a DC decision is binding now. We envisage that members of the panel would be appointed for a specified period (so as to provide continuity) but with a number of other individuals in reserve in case a panel member is unavailable. The costs associated with a referral to the independent panel would be paid from the DCs' budget.

The proposal has some similarities to the External Review process but it would not involve the written or oral advocacy that is associated with that process. Instead, the panel would decide on the basis of a review of the same materials that are available to the DCs. Furthermore, DC Members would not have to vote on a question before

[1] US transactions typically do not incorporate the Restructuring Credit Event, which can often be difficult to apply. Furthermore, US insolvency arrangements often involve Chapter 11 bankruptcy proceedings, which are easily identified as a Bankruptcy Credit Event.

the question is referred to the panel (in contrast to the External Review process, which is initiated only when a Supermajority of votes is not achieved).

Consultees who expressed support for this proposal saw it as a means of enabling decisions to be reached more quickly, especially where it is proving difficult for the relevant DC to decide. Another advantage is that, to the extent that the panel is used, the decision will have been taken in a demonstrably independent manner. It will therefore be clear that the decision was not influenced by the DC Members' own interests.

One consultee expressed a reservation that, if the DCs have the right to refer questions to such an independent panel, they could avoid grappling with difficult issues by making liberal use of the right. We do not, however, see this as a problem. The primary objective should be to ensure that the right decision is taken in a timely manner. If that objective is achieved, it should not matter whether the decision-maker is the DC or the independent panel. Indeed, if all controversial decisions were taken by such a panel, this should largely resolve any concerns over conflicts of interest.

Another reservation that was expressed is that, although the DCs are not bound by their previous decisions, in practice they tend to follow them. This helps to promote consistent decision making and predictability, which could be lost if the independent panel did not follow the same practice. We agree with these views about the importance of previous decisions. However, we see no reason why an independent panel should not attach the same weight to previous decisions (including those of the DCs) as the DCs themselves. The position is analogous to decisions taken by UK planning authorities, which must treat previous decisions in similar cases as material considerations and, before departing from them, must have regard to the importance of consistency and give reasons for the departure.[1]

A more generally expressed reservation was that it would be extremely difficult to find individuals to serve on an independent panel with the depth of knowledge of the credit derivatives market that is possessed by the existing DC representatives. This could result in the panel failing to give proper regard to the commercial background and the underlying purpose of the 2014 Definitions.

Although we think it is true that members of the panel are unlikely to be specialists in credit derivatives, it does not follow that they will be unable or unwilling to take into account the commercial background and purpose where it is appropriate to do so. As explained in paragraph 3.4 above, these are relevant considerations under English law and New York law and so the panel will be required to give due weight to them. However, we do think it is true that the considerations that are potentially relevant may not be immediately apparent to non-specialists. The panel may, therefore, not be fully appraised of all the arguments for or against a particular construction. In contrast, in a court hearing (which will often be before a judge who does not have direct experience of the matters in dispute), and indeed the External Review process, each side will set out the arguments they wish to advance.

In our opinion, this issue could be addressed by the DC (or the DC Secretary on its behalf) preparing a briefing document which summarises the point at issue and draws the panel's attention to the arguments in favour or against a particular

[1] *North Wiltshire DC v Secretary of State for the Environment* (1993) 65 P&CR 137.

conclusion. This would include reference to any commercial considerations. Any such document should be posted on the DC website. The panel would also be provided with any previous decisions that are relevant. We understand that, under the current arrangements, the DC Secretary often prepares such a briefing document for the benefit of the relevant DC. To provide such a briefing to the independent panel may, therefore, not involve much additional work. Furthermore, as the panel gains experience, the extent to which it needs to have commercial matters explained to it is likely to decrease.

We recognise that this model is likely to make the External Review process largely redundant because a DC is likely to refer intractable questions to the panel before any votes are cast. However, External Review would remain available and could be used where, for example, there are conflicting views and DC Members consider that the matter would best be decided in light of the written and oral advocacy that is entailed in that process.

4.4.2 Mandatory referral

A variation on this model would involve all Credit Event and Successor questions being referred to an independent panel (except perhaps those which raise no novel issues and no difficult questions of fact). This was in fact suggested by two market participants that we consulted, albeit that they envisaged a single law firm taking the decisions. It was also the preferred structure of the regulators we spoke to.

We do not support the principle of all decisions being taken by a single law firm or a single individual because we think it places too much influence in the hands of one body, especially under a structure which has no appeals process. However, there is a legitimate question about whether it is necessary to have the existing DC structure at all, at least for questions about Credit Events and Successors. If an independent panel is capable of performing the role, why should it not decide all such questions? The advantages would be a clear absence of any conflict of interest, a potentially less resource-intensive process than at present and perhaps the need for less onerous compliance procedures than would otherwise be the case. It would also reduce the litigation and reputational risk to which some DC Members currently feel exposed.

Although we can see the attractions of this model, we are not recommending it at this stage because, assuming that there is a willingness to establish an independent panel, we think it would be better to give it a smaller role at first, with the potential for its remit to be expanded at a later time. This would enable a decision about any such expansion, and any consequent reduction in the scope of the DC's functions, to be taken on the basis of evidence about how well the model has worked in practice.

4.5 Eligibility to act as a non-dealer DC Member

Although the appointment of one or more independent DC Members would help to address any over-representation of dealers on the DC, most consultees commented that more buy-side engagement would be desirable. It has been suggested that, rather than a buy-side market participant being eligible for appointment to a DC if it has US$1 billion notional amount of outstanding credit derivatives transactions referencing a single Reference Entity, the threshold should be reduced to, say, US$100-200,000,000. We think this suggestion has merit – such thresholds are used as a proxy for sophistication about credit derivatives matters but a sufficient level of sophistication can probably be achieved at a lower level.

Furthermore, if a DC position is unfilled, it would seem sensible to allow applications for the position to be made outside the usual annual cycle.

Another suggestion is that a non-dealer should be able to put itself forward for membership of individual DCs, rather than having to join all the DCs. For example, an entity based in New York with no international operations may prefer to join the Americas DC only. We can see the benefit of this proposal. It is not attractive for individuals who are located, say, in New York to have to join meetings held in Asian business hours. Furthermore, if all members of the Europe, Middle East and Africa DC were based in London, it would be possible to hold meetings earlier in the day, which could lead to decisions being taken, and announced, more quickly.

4.6 Number of DC Members

We think there is a good argument for aligning the number of dealer and non-dealer members with the participation that can be expected. Although the DC Rules provide that, if there are fewer than 15 DC Members for a region, that region's DC will comprise the number of DC Members that are available,[1] relying on this provision indefinitely is not ideal. If, in practice, only eight dealers are likely to be willing to act as DC Members, we think it would be better for the DC Rules to state that there will be eight dealer members of the DC. If the proportions of dealer and non-dealer members contemplated by the DC Rules are to be retained, this would imply a reduction in the number of non-dealer DC Members to four. Although there are currently only three non-dealer DC Members, it seems reasonable to aspire for a higher number. This would be in addition to any independent DC Members that are appointed under the proposals discussed in paragraph 4.3 above.

At the same time, we think the DC Rules could be streamlined by removing the provisions relating to the appointment of consultative (non-voting) dealer or non-dealer DC Members.[2] These only apply where there is a surplus of market participants willing to act as DC Members. The provisions relating to CCP membership would not be affected.

[1] DC Rules, Section 1.8(f).

[2] DC Rules, Sections 1.6(a)(iii) and 1.6(c)(ii).

5 Enhanced conflict management procedures

5.1 Existing protections

The DC Rules require DC Members and the CCPs represented on the DCs ("**DC Participants**") to enter into an agreement with the DC Secretary (the "**Standard Agreement**") containing certain representations.[1] In summary:

(a) each DC Participant must represent that it has "written policies and/or procedures reasonably designed to identify and manage conflicts of interest arising from its role as a DC Participant and the potential profits or losses from trading or holding economic positions in instruments whose price may be impacted by a DC Resolution";

(b) these policies or procedures must provide that any individual who is part of a team that performs, or exercises authority over the performance of certain activities (such as the pricing, trading or marketing of credit derivatives) in respect of certain business lines must not be one of the decision-makers unless the DC Participant determines that he or she is "sufficiently independent of" the activities of the relevant business line to be able to act as such without creating an "unmanageable conflict of interest";

(c) if the policies or procedures require the relevant decision-maker to be part of a legal, compliance, control or similar department or function of the DC Participant, they will automatically comply with the requirement mentioned in (a) above;

(d) if the DC Participant has voting rights, the process by which its votes are cast must be addressed by its written policies or procedures, including the level of seniority or experience of the individuals involved and the general governance of the decision-making process;

(e) the DC Participant must have written policies and/or procedures that are reasonably designed to ensure the appropriate handling of material non-public information in accordance with any applicable laws or regulations;

(f) the DC Participant must have written policies and/or procedures or other mechanisms in place to provide for ongoing internal oversight of its compliance with the DC Rules and any related policies and procedures; and

(g) a copy of the relevant policies or procedures must be retained for at least five years.

However, subject to any requirements relating to confidential or non-public information, the discussion of relevant information with other individuals within the DC Participant's organisation, including those who are excluded from acting as decision-makers, is not prohibited. Furthermore, if an individual knows the economic position of the DC Participant (or that of a relevant business line) that might be impacted by a DC resolution, such knowledge need not, by itself, prevent that individual from being involved in the decision about how the DC Participant votes.

5.2 Observations

The effectiveness of information barriers and other compliance policies to manage conflicts of interest depends on both the content of the policies and how well they are observed in

[1] DC Rules, Section 1.8(b).

practice. One of the regulators to which we spoke made the point that the banks that provided LIBOR submissions had policies to manage conflicts of interest and yet this did not prevent manipulation of the benchmark. In general, the greater the conflict of interest that exists, the less desirable it is to rely on compliance policies to manage it.

The minimum standards required under the DC Rules have a number of significant limitations. Although the DC decision-makers must be "sufficiently independent of" the relevant business lines (for example, by being part of a legal or compliance department or a control function), they are permitted to know the economic position of the DC Participant. However, this is precisely the information that is capable of influencing the decision. In these circumstances, protection against conflicts of interest is based not on information barriers but on the integrity of the decision-makers and their ability to avoid being influenced by the information (whether deliberately or as a result of unconscious bias).

It is also notable that the DC Rules impose few limitations on the nature of the discussions that may take place between the DC decision-makers and individuals who are excluded from acting as decision-makers. Although certain types of discussion (for example, about whether there is sufficient liquidity for an Auction to be held) are to be expected, the DC Rules would not prohibit conversations in which an individual in a DC Member's business unit tries to influence the outcome of a DC Credit Event Question.

A number of DC Members informed us that their policies and procedures go further than the minimum prescribed by the DC Rules. Although individuals who participate in DC decisions may know about particular transactions or the trading interest of a particular desk, they must not be aware of the net economic position of the DC Member they represent. Similarly, communication with individuals who are excluded from the decision-making process is permitted on a more limited basis than is contemplated by the DC Rules. In general, therefore, the standards that are observed in practice tend to be higher than the minimum ones prescribed. However, not all DC Members will adopt such an approach and it is open to those that do to change their policies at any time.

Furthermore, other market participants have no insight into the compliance procedures that are followed in practice – they merely know that DC Members must comply with the minimum standards set out in the DC Rules. This limits the extent to which they can derive comfort from the existence of compliance procedures.

One of the arguments advanced in support of the standards set out in the DC Rules is that the role of an individual in a DC Member's legal department is to stand apart from the immediate trading interests of the firm's business lines and adopt a wider perspective. An individual who is professionally qualified will also be subject to enforceable professional standards. In any event, the representatives will be aware that, if they decide a question in a particular way, this may set a precedent in other cases where the firm may have a different economic interest. It was also argued that each DC is sufficiently large that a single DC Member could not affect the outcome, especially as most DC decisions are unanimous.

There is undoubtedly force in these points. However, the risk of being influenced, consciously or unconsciously, by the information held (or by the views of other individuals within the DC Member's organisation who are themselves so influenced) remains. Furthermore, any DC Member is able to influence the formation of a consensus and, if two or more of them acted in the same way (whether or not in collusion with each other), the influence they have will be all the stronger. In any event, the question is not merely whether

the decision-making process has been affected but whether the market can be confident of this.

One of the regulators to which we spoke also made the point that, although the DC Participants have given certain representations to the DC Secretary, the DC Secretary does not check whether they are observed in practice and has no process for enforcing any breach. Each DC Member will no doubt have its own internal audit procedures and will be subject to regulatory supervision. However, neither the DC Secretary nor other DC Members (nor, by extension, other market participants) have any way of knowing whether a particular DC Member is complying even with the standards contemplated by the DC Rules.

5.3 Alternative approach

One way of addressing these issues would be to require DC Participants to adhere to a code of conduct which sets out a higher set of standards than the minima prescribed by the current DC Rules. Some of the regulators we spoke to referred to the codes of conduct that were prepared in connection with interest rate benchmarks and suggested that a similar approach could be taken.

There are a number of significant differences between benchmark administration and the DC process. In particular, DC decisions involve an exercise of professional judgment and are not based on submissions, or even estimates, of data. The standards that apply to benchmark administration could therefore not be used without modification. However, relevant parts of these standards[1] could provide a starting point for a set of enhanced requirements. In particular, we recommend that:

(a) any individual who is involved in a DC Member's decision about how to vote at a DC meeting must not be aware of (i) the DC Member's net position in credit derivatives which reference the relevant Reference Entity (or related positions) or (ii) any other information that would lead a reasonable person to believe that there is real possibility of bias; and

(b) such individuals should be prohibited from discussing with individuals who are excluded from the decision-making process the merits of any DC Credit Event Question or DC Question about Successors (or about how the DC Member should vote on such matters).

We do not think that such an approach would be problematic for the dealer members of the DCs as their compliance procedures may already be sufficient. Indeed, the introduction of a code of conduct was suggested by one such dealer member. However, it may present more of a challenge for buy-side members of the DCs. For example, it may be difficult to ensure that those involved in deciding how a vote should be cast are not aware of the net economic position of the relevant DC Member.

Where a conflict of interest cannot be effectively managed, one way in which the issue could be addressed would be for the relevant DC Member to recuse itself from the DC Question. In contrast to members of an External Review Panel,[2] however, DC Members are not permitted by the DC Rules to recuse themselves on this basis. If a binding vote is held, each DC Member with voting rights is required to vote unless the DC Member (or an affiliate) is

[1] See, for example, the EU Benchmarks Regulation, Regulation 2016/1011 of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds and amending Directives 2008/48/EC and 2014/17/EU and Regulation (EU) No 596/2014 [2016] O.J. L171/1, Annex I.

[2] DC Rules, Section 4.3(c).

the Reference Entity under consideration.[1] We recommend that this rule (together with the related quorum provisions) is changed so that recusals are permitted on conflict of interest grounds.

We recognise that there is a tension between a desire for more buy-side engagement with the DC process and the imposition of enhanced requirements relating to the management of conflicts of interest. However, we think the priority should be to ensure that conflicts of interest are properly managed. In any event, we do not think that the challenges in this area are insuperable, even for buy-side DC Members.

[1] DC Rules, Section 2.3(b).

6 DC Questions

6.1 Requirements of the DC Rules

The DC Rules provide that, in order to convene a DC, an Eligible Market Participant must "request a meeting of a Committee by notifying the DC Secretary of the issue(s) it believes should be deliberated by such Committee".[1] Any such request should include "a reasonably detailed description of all of the issues that the relevant Eligible Market Participant believes the relevant Committee should deliberate" and "if applicable, supporting information that is consistent with the definition of Publicly Available Information".[2] In fact, the question may not be deliberated unless the Committee has determined that "Publicly Available Information has been provided to the DC Secretary".[3]

"Publicly Available Information" is defined as:

> "information that confirms any of the facts relevant to the determination that the Credit Event or Potential Repudiation/Moratorium, as applicable, described in a Credit Event Notice or Repudiation/Moratorium Extension Notice have occurred and which:
>
> (i) has been published in or on not less than the Specified Number of Public Sources (regardless of whether the reader or user thereof pays a fee to obtain such information);
>
> (ii) is information received from or published by (A) the Reference Entity (or, if the Reference Entity is a Sovereign, any agency, instrumentality, ministry, department or other authority thereof acting in a governmental capacity (including, without limiting the foregoing, the central bank) of such Sovereign), or (B) a trustee, fiscal agent, administrative agent, clearing agent, paying agent, facility agent or agent bank for an Obligation; or
>
> (iii) is information contained in any order, decree, notice, petition or filing, however described, of or filed with a court, tribunal, exchange, regulatory authority or similar administrative, regulatory or judicial body,
>
> provided that where any information of the type described in Sections 1.35(a)(ii) or (iii) is not publicly available, it can only constitute Publicly Available Information if it can be made public without violating any law, agreement, understanding or other restriction regarding the confidentiality of such information...
>
> Without limitation, Publicly Available Information need not state (i) in relation to Section 3.28 (Downstream Affiliate), the percentage of Voting Shares owned by the Reference Entity and (ii) that the relevant occurrence (A) has met the Payment Requirement or Default Requirement, (B) is the result of exceeding any applicable Grace Period, or (C) has met the subjective criteria specified in certain Credit Events."[4]

For these purposes, the references to a "Credit Event Notice" and a "Repudiation/Moratorium Extension Notice" are deemed to be references to a DC Credit

[1] DC Rules, Section 2.2(a).

[2] ibid.

[3] DC Rules, Section 2.2(b).

[4] 2014 Definitions, Section 1.35.

Event Question or a notice to the DC Secretary under Section 3.1(a) of the DC Rules. The Specified Number is deemed to be two.[1]

6.2 Implications

The requirements that have to be satisfied to ask a DC Credit Event Question are materially less onerous than those which have to be satisfied where a Credit Event Notice and a Notice of Publicly Available Information are given:

(a) A Credit Event Notice must "contain a description in reasonable detail of the facts relevant to the determination that a Credit Event has occurred",[2] whereas a request to convene a DC merely has to include a reasonably detailed description of the *issue* that the DC is asked to deliberate. For example, the DC may simply be asked whether a Bankruptcy Credit Event has occurred.

(b) A Notice of Publicly Available Information must cite Publicly Available Information "*confirming* the occurrence of the Credit Event or Potential Repudiation/Moratorium, as applicable" and contain a copy, or a description in reasonable detail, of that Publicly Available Information,[3] whereas a request to convene a DC merely needs to be accompanied by "information that confirms *any of the facts* relevant to" the proposed determination.

This has two consequences. First, the DC process enables DC Credit Event Questions to be asked at a very high level of abstraction. For example, in May 2023, the question asked was "Has a Bankruptcy Credit Event occurred with respect to Credit Suisse Group AG?". One of the limbs of this provision applies where the Reference Entity:

> "becomes insolvent or is unable to pay its debts or fails or admits in writing in a judicial, regulatory or administrative proceeding or filing its inability generally to pay its debts as they become due".[4]

The Eligible Market Participant which asked the question was not required to identify (still less describe) the particular facts that could be said to support an assertion that this test was satisfied and the supporting information provided ran to over a thousand pages. The onus was therefore placed on the DC to analyse this information, identify any facts which were potentially relevant and form a conclusion on the point. This involved a significant amount of work.

Secondly, although we understand that, in practice, the requirement for information that confirms *any* of the relevant facts is interpreted as a requirement to provide information that confirms the *key* facts, a DC Credit Event Question can be asked without sufficient information being provided to enable the relevant DC to form a conclusion on the point. Although the DCs are under no obligation to research, investigate or supplement any information (or verify its veracity),[5] in practice, they often do seek out additional information to help them to make a determination. For example, they may contact the relevant Reference Entity and ask for further information. This may be done either because the information held

[1] DC Rules, Section 2.2(b).

[2] 2014 Definitions, Section 1.32.

[3] 2014 Definitions, Section 1.34.

[4] 2014 Definitions, Section 4.2(b).

[5] DC Rules, Section 2.5(b).

is clearly insufficient or because it is ambiguous and the DC considers that corroboration would be desirable.

Again, this can involve a considerable amount of work. It can also introduce significant delays into the decision-making process, depending on how easy it is to obtain the additional information. Although the DCs sometimes announce that they are looking for additional information about a particular matter, this does not always happen and it can be unclear to market participants why DC meetings are being repeatedly adjourned.

6.3 Proposal

6.3.1 Type of public information that should be provided

Several consultees stated that the DC Rules should be clearer about what supporting information must be provided when a DC Credit Event Question is asked. We agree with this view. This is partly because Eligible Market Participants should know where they stand and partly because they should be encouraged to provide a more complete set of information at the outset. The first consideration is particularly important because, for settlement to be required, the Credit Event must have occurred on or after the "Credit Event Backstop Date".[1] This is the date 60 days prior to the date on which the DC Credit Event Question is effective and on which the DC is in possession of Publicly Available Information.[2]

We do not, however, think that the information requirement should be as onerous as that required for a valid Notice of Publicly Available Information. In the case of a bilateral settlement, the Seller is required to settle the transaction if, *inter alia*, a Notice of Publicly Available Information is given and so the information cited by such a notice must be of sufficient quality to expect the Seller to act on the basis of it.[3] In the case of a DC Credit Event Question, the provision of supporting information is not a contractual threshold that, if crossed, will lead to settlement. Instead, the DC must evaluate the information provided and form a judgment about whether a Credit Event has occurred. If information is provided from an unreliable public source, the DC may simply decide that it is not sufficiently credible to reach such a conclusion. On the other hand, it may consider the information to be influential even though it does not fall within the definition of Publicly Available Information.

It Is also arguable that the requirements for a Notice of Publicly Available Information are *too* onerous. For example, some of the Credit Events depend on certain events or circumstances having occurred in relation to an "Obligation". The term "Obligation" includes an obligation of the Reference Entity (directly or as provider of a Relevant Guarantee) which satisfies certain tests. If the obligation in question is a guarantee, it may be extremely difficult to find Publicly Available Information which confirms that the guarantee falls within the definition of "Relevant Guarantee".[4] On the other hand, there may be other Eligible Information about the terms of the guarantee which clarifies the position.

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1 2014 Definitions, Section 1.28.

2 i.e. the Credit Event Resolution Request Date: 2014 Definitions, Section 1.30.

3 Although a Seller can decline to settle a transaction if it can show that the asserted Credit Event did not in fact occur, it will generally rely on the information cited in the Notice of Publicly Available Information when making this assessment.

4 See, for example, the decision of the Asia Ex-Japan DC on 19 September 2017 in relation to Noble Group Limited.

This is not to say that the requirement for Publicly Available Information should be dispensed with completely. There is a good argument that it should be retained for the key elements of each Credit Event, on the basis that it provides a degree of certainty about the minimum evidential standards that must be satisfied. It would also help the DCs to avoid having to make judgments about the weight that should be given to information derived from a relatively unreliable source about critical aspects of the Credit Events. It is, in any event, required by the 2014 Definitions.[1]

6.3.2 Clarity about information requirements

To provide the necessary clarity, we recommend that, for each of the listed Credit Events, the DC Rules provide a checklist that identifies each of the elements that need to be confirmed and whether Publicly Available Information is required or whether it is sufficient to provide other Eligible Information instead. There will also be some elements that do not need to be confirmed at all. For example, there will be no need to provide evidence that any Payment Requirement or Grace Period has been exceeded.

We recommend that, when asking a DC Credit Event Question, the relevant Eligible Market Participant should be required to complete the checklist by confirming that Publicly Available Information or (where relevant) other Eligible Information has been provided in support of each of the specified elements. The completed checklist should be required to state expressly the document and page reference where the information in question can be found.

We recognise that, in some instances, rather than the supporting documents expressly stating the existence of certain facts, they will provide information from which it could be argued that certain facts can be inferred. For example, an Eligible Market Participant may wish to advance the argument that it can be inferred from the fact that resolution action has been taken in respect of a bank that the bank is insolvent. The completed checklist should enable the Eligible Market Participant to cite information from which it claims the requisite inferences can be drawn. However, it should be required to do so by particularising the information relied on (and specifying the document and page reference where that information can be found), rather than simply making a general assertion.

If this approach is adopted, any gaps in the required information should be apparent at the outset. If there are any gaps, the question should not be considered by a DC because the DC will not be in a position to conclude that the relevant Credit Event has occurred. In other words, the DC Credit Event Question should be treated as ineffective. In these circumstances, there should be little prospect of market participants seeking to trigger a bilateral settlement because there will be insufficient information for a Notice of Publicly Available Information to be given.

If a DC Credit Event Question is ineffective due to a lack of information, this should be clearly stated on the DC website. The DC Secretary should be given authority to make such a determination (and update the website accordingly), albeit with the ability to refer the matter to a DC in cases of doubt). If further information comes to light, any Eligible Market Participant should be able to add to the information on the

[1] 2014 Definitions, Section 1.30.

file so that, if the relevant gaps have been addressed, the DC Credit Event Question may be accepted for deliberation.

6.3.3 Result of DC deliberations

The fact that there are no gaps in the information provided with a DC Credit Event Question does not, of course, mean that the relevant DC will conclude that a Credit Event has occurred. The DC will still need to assess the information and decide whether it supports such a conclusion. Amongst other things, the DC will need to form a view about the credibility of the information, having regard to its source.

In some cases, it will be possible for the DC to conclude that a Credit Event has occurred; in others, they may conclude that it has *not* occurred. However, a third possibility is that the DC forms the view that there is insufficient evidence to reach either conclusion. Under the DC Rules as they currently stand, the alternatives available are for the DC to make a "No Credit Event Announcement",[1] to dismiss the DC Credit Event Question[2] or to continue to deliberate the issue pending the obtaining of additional information.

In our opinion, none of these options is ideal. If the question is dismissed, market participants may attempt to trigger bilateral settlement by giving Credit Event Notices and Notices of Publicly Available Information.[3] The view expressed by the DC that the Eligible Information available does not confirm the occurrence of a Credit Event will not be binding on Sellers and disputes may arise about whether settlement is required. In the case of a widely-traded Reference Entity, this could be problematic – the DC process was established precisely to avoid this type of scenario.

As a result, the DC may be inclined to make a No Credit Event Determination. However, this is unattractive because it implies that a Credit Event has not occurred even if the issue concerns a lack of evidence.

The third alternative avoids this problem by simply deferring the decision. However, in our view this is also unattractive because it runs the risk of creating the impression that the DC is slow to decide and unwilling to grapple with the issue it is facing. We think that, if the DC concludes that there is insufficient admissible evidence to justify a conclusion that a Credit Event has occurred but does not want to dismiss the question, it should be open to it to make a "not proven" determination. In effect, this would involve the DC announcing that it is unwilling to conclude, on the basis of the evidence it has reviewed, that a Credit Event has occurred due to the absence of reliable evidence on one or more stated matters.

Such a determination would be binding on market participants, in the sense of preventing them from giving a Credit Event Notice and Notice of Publicly Available Information asserting that the Credit Event has occurred, but it would be open to any Eligible Market Participant to provide further Eligible Information for the DC to

[1] 2014 Definitions, Section 1.28.

[2] 2014 Definitions, Section 1.27.

[3] This scenario occurred following the dismissal of a DC Credit Event Question in relation to Noble Group Limited in August 2017. The DC was later asked to interpret the 2014 Definitions to determine whether market participants could validly deliver Credit Event Notices and Notices of Publicly Available Information: https://www.cdsdeterminationscommittees.org/documents/2017/09/aej-dc-statement-09192017-noble-limited-group.pdf

consider. If such further Eligible Information is sufficient to persuade the DC that a Credit Event has occurred, it would make a determination accordingly.

6.3.4 Should the DCs carry out their own research?

Under the model proposed in paragraph 6.3.3 above, the DCs would not try to obtain additional information to supplement the information they have considered. Instead, the onus would be on market participants to obtain any additional information that is required.

One of the comments made by the buy-side consultees we spoke to was that they believed that the DCs *should* be responsible for obtaining any additional information that may be required because the dealers represented on the DC are in the best position to obtain this information. In particular, they may have relationships with the relevant Reference Entity and, in any event, will have greater resources to make the necessary enquiries.

We are not persuaded by this argument because, although it may be the case that dealers are in the best position to obtain any missing information, it will remain open to such dealers (acting through their business units) to do so. There may be good business reasons for making the enquiries (for example, the dealers may want to trigger the settlement of their own contracts, they may be asked by a client to do so or they may simply regard the matter as good business practice). Dealers that are not represented on the DC will be in a similar position. However, it does not follow that the work should be done by the DC, acting in its capacity as such.

This may not in fact represent a great difference in substance from the existing position because, where additional information is sought, it will generally be sought via the DC Members' business units. The research will not be carried out by the lawyers on the DC. However, putting the onus on market participants to do this work (even if, in practice, those market participants are dealers which are represented on the DC), rather than carrying it out behind the scenes, should make the process more transparent.

We also think such an approach is desirable to avoid market participants being given the impression that the DCs are responsible for ensuring that they have sufficient information to make a determination. Where settlement occurs bilaterally, the Buyer assumes responsibility for preparing a Notice of Publicly Available Information. If it is unable to obtain the necessary information, settlement will not take place. We see no reason in principle why the position should be different where the DC determinations process is used.

Finally, one of the concerns identified by several consultees was the sheer volume of work that is associated with DC membership. As noted above, it is possible that this is one of the factors deterring some market participants from becoming DC Members. Making it clear that the DCs are not responsible for seeking out further information should help to reduce the burden associated with DC membership.

6.4 Successor questions

We think Successor questions can be treated differently because there is a process in place to identify corporate events which potentially give rise to a Successor. This process is managed by S&P Global Inc, which is also responsible for collating information about the event. Further analysis is done by the DC Secretary's legal advisers after receiving the

information from S&P Global Inc. Although this process can be time-consuming, as the initial work is delegated, the relevant facts can be presented to the DCs to enable a decision to be taken. Such decisions tend to be less controversial than those relating to Credit Events and, once the facts have been collated, are easier to resolve.

7 Statements of case

7.1 Disclosure

A separate question that arises is whether an Eligible Market Participant should be entitled to provide a statement of case in support of an assertion that (for example) a Credit Event has, or has not, occurred. We understand that such documents are sometimes submitted and that some DC Members review them. Others decline to do so, partly because they cannot be confident that the document will not contain private information (which would not be admissible).

One point we would make at the outset is that, if statements of case are accepted, they should be posted on the DC website and thereby made available to other market participants. There should also be a facility for other market participants to put forward alternative arguments. The current practice, under which DC Members read papers advocating a particular approach without the papers being disclosed to the market, should be discontinued as, in our opinion, it is inconsistent with general principles of procedural fairness. The point was recently made by Lord Leggatt in *Potanin v Potanina*:[1]

> "Rule one for any judge dealing with a case is that, before you make an order requested by one party, you must give the other party a chance to object. Sometimes a decision needs to be made before it is practicable to do this. Then you must do the next best thing, which is—if you make the order sought—to give the other party an opportunity to argue that the order should be set aside or varied. What is always unfair is to make a final order, only capable of correction on appeal, after hearing only from the party who wants you to make the order without allowing the other party to say why the order should not be made.
>
> This fundamental principle of procedural fairness may seem so obvious and elementary that it goes without saying."

The DC process is different from court proceedings in certain important respects. In particular, it does not involve *inter partes* litigation. However, the decisions taken by the DCs are binding on parties with divergent interests and have the effect of resolving matters which may be in dispute between them. It is not necessarily unfair for the DCs to decide these matters without hearing any representations at all. However, it is unfair for the decision to be taken after hearing from one side without giving others the opportunity to advance arguments to the contrary.

The choice to be made, therefore, is between (a) not receiving any statements of case at all (other than as described in paragraph 6.3.2 above) and (b) being prepared to receive them but on the basis that they are made public and other Eligible Market Participants are given a short period in which to respond.

7.2 Consultees' views

It is clear that there is a wide divergence of views on this point. Non-DC consultees (especially on the buy-side) felt strongly that statements of case should be accepted and should be read by DC Members. They accepted that the documents may need to comply with certain parameters but felt it was important that there should be a facility to advance arguments that DC Members might not otherwise consider. They had no objection to the

[1] [2024] 2 WLR 540.

documents being made publicly available or to others having the opportunity to respond to them.

Although some DC Members said they found statements of case valuable, in enabling them to understand the point at issue, others said that they have sufficient expertise to appreciate the arguments without a paper setting them out. The statements of case that are provided are said to be of variable quality and sometimes advance rather tenuous arguments at great length. The arguments can also be advanced in somewhat aggressive terms and it is not uncommon for them to be accompanied by threats of litigation or allegations of impropriety. What may be appropriate for pleadings in US litigation is not necessarily appropriate for the more inquisitorial DC approach. There was a particular concern that, if any Eligible Market Participant is able to express a view on an issue, the DC website would become like a blog, with a multitude of conflicting comments, not necessarily all focussed on the issues in hand.

A related concern that was expressed is that an Eligible Market Participant could put forward an argument (in the knowledge that it would appear on the DC website) not in the belief that there is much merit in the argument but as a prelude to opening negotiations with a counterparty to unwind a transaction at an advantageous price. Furthermore, it is said that even a tenuous argument that there has been a Credit Event has the potential to move the market. The consultee suggested that the DC website could even be used as a vehicle for market manipulation.

7.3 Comments

We start from the position that, as a matter of principle, it would be desirable for Eligible Market Participants to be able to advance arguments in favour of, or against, a particular conclusion. The DCs adjudicate on issues which have important economic implications and we do not think it is unreasonable for a party that considers a Credit Event to have occurred to wish to have its views considered (whether or not others consider the views to have weight). It seems to us that this is an important part of ensuring that the DCs retain the confidence of the market. If market participants are given little or no input into the process, there is a risk that they will feel disenfranchised.

We are not persuaded by the argument that DC Members have sufficient expertise to be able to understand all the relevant arguments. In most cases, that may be true but it is not a conclusion that can be reached *a priori*. It is also an assertion that must be viewed with scepticism. It is the nature of difficult cases that they sometimes involve arguments that would not otherwise have been thought of. In any event, the point at issue is whether market participants that are not represented on the DC can be reassured that their views will be taken into account. If there is no facility to enable those views to be expressed, it is difficult to see how that reassurance can be provided.

That said, we do think that some parameters will need to be observed if statements of case are to be accepted:

(a) Any document submitted should be limited to a discussion of the issue before the DC. It should not, for example, make allegations of impropriety or contain threats of litigation.

(b) There should be a limit to the length of any submission. The maximum length should be sufficient to enable the points to be properly articulated, albeit succinctly.

(c) Any statement of case should be prepared and submitted by a qualified lawyer or a law firm. This should enhance the quality of submissions, deter frivolous submissions and reduce the number of submissions made.

(d) Those submitting a statement of case should be required to represent and warrant the accuracy of the statements made and that the document does not contain any information that is not in the public domain. There should potentially also be an indemnity in favour of DC Members and the DC Secretary for any losses caused as a result of a breach of these representations and warranties.

(e) The identity of the persons making the submissions should be disclosed.

If these conditions are not satisfied, the submission would be rejected by the DC Secretary.

The last of the conditions we have listed requires further discussion. At present it is possible to ask a General Interest Question anonymously and, indeed, most questions are asked in this way. Such an approach enables market participants to avoid having to disclose to the market what net trading interest they have. It also prevents banks that have a client relationship with a Reference Entity from being deterred from asking questions relating to the Reference Entity.

For these reasons, we think the ability to ask a General Interest Question anonymously should be retained. However, it is arguable that the balance of convenience changes when an Eligible Market Participant chooses to go further than this. There is a strong argument that it should not be able to advocate for a particular result behind a cloak of anonymity. Instead, it could be said that its identity should be disclosed in the interests of market transparency. Removing the protection of anonymity may deter market participants from advancing frivolous arguments or taking an extreme position. If they were to do so on a consistent basis, they would develop a reputation for making bad points, which the market could take into account when assessing the likelihood of the DC making a Credit Event determination. A lack of anonymity should also deter Eligible Market Participants from making statements that might be regarded as manipulating the market.

We recognise that, even if submissions are made in good faith and in the name of the Eligible Market Participant in question, there is the potential for market movements to occur. However, this is also the case where a DC Credit Event Question is asked without any supporting argument, or where arguments are advanced in press articles. Market movements per se should not be regarded as problematic where they reflect the market's evaluation of publicly available information, even if particular market participants fail to draw the right conclusions from the information.

That said, an alternative approach would be to require only the identity of the lawyer or law firm providing the statement of case to be disclosed to the market. The identity of the clients for which it is acting would be disclosed to the DC Secretary (and the information would be available to any regulators on request) but it would not be made public. It could be argued that this achieves the right balance between enabling Eligible Market Participants to articulate their arguments and ensuring that they are not deterred from asking DC Credit Event Questions.

Of these two approaches, we are inclined to support the first (disclosure to the market of the identity of the Eligible Market Participant advancing the arguments). This appears to us to be more consistent with the goal of market transparency (which, in other respects, the buy-

side consultees strongly support). However, we recognise that views may differ on this point and so both alternatives should go forward for wider consultation.

8 DC deliberations

8.1 Acceptance of questions

For an issue raised by an Eligible Market Participant to be deliberated by a DC, at least one DC Member with voting rights (or, in the case of a General Interest Question, two such members) must have agreed to deliberate the issue.[1] This is designed to filter out any questions that do not have wider market significance (so that, for example, in the case of an alleged Credit Event, bilateral settlement may be appropriate). However, a number of consultees made the point that it should be possible to identify criteria that, if satisfied, will result in a question automatically being accepted. This should be the case, for example, if the relevant Reference Entity is a component of an index or the volume of outstanding transactions referencing the Reference Entity exceeds a prescribed threshold. We agree with this suggestion, as it would eliminate an unnecessary procedural step and help to speed up the decision-making process.

8.2 Standard

The DC Rules provide that:

> "Each DC Voting Member shall perform its obligations under the Rules in a commercially reasonable manner in Resolving a DC Question".[2]

A number of DC Members made the point (with which we agree) that this provides very little guidance about how they should resolve questions of fact and points of contractual interpretation. In particular, it does not explain what the DC Voting Members' "obligations under the Rules" are in respect of these matters.

Although the DC Rules are governed by New York law, and so New York law governs the proceedings of the DCs, in our view, it is clear that questions of the interpretation of the 2014 Definitions must be resolved by applying the governing law of the transactions in question. Although the DC Rules provide that, in the case of an External Review, any decision made by the External Reviewers must be made without regard to the governing law of a transaction, there is no equivalent provision for decisions of a DC.

In practice, little is likely to turn on this because it would be unusual for English and New York law (the two principal jurisdictions that are relevant) to yield a different result on a point of contractual interpretation. However, it is important that DC Members have a clear understanding of the legal principles that apply on such a point. In some respects, these are not particularly intuitive and, indeed, have evolved significantly in recent years (at least under English law). We think it would be helpful for a document to be prepared which summarises the key principles under both English and New York law. It would not be appropriate for this to form part of the DC Rules because the law may change and the document will need to be kept up to date but the DC Secretary could be charged with ensuring that such a document is prepared. We do think the DC Rules should make it clear which governing law the relevant DC is required to consider.

We also think that DC Members should be provided with guidance about the correct approach to questions of fact. This is a question of New York law (as the governing law of the DC Rules), although it is unlikely to differ materially from English law. In our view, questions of fact must be determined by the DCs, by reference to the relevant Publicly

[1] DC Rules, Section 2.1(a).

[2] DC Rules, Section 2.5(b).

Available Information and other Eligible Information, on the balance of probabilities. We think it would be preferable for the DC Rules to state this expressly. We do not think it can be right to say that, say, a criminal standard of proof applies or that DC Members can choose for themselves what standard to apply (subject to acting in a commercially reasonable manner).

On the other hand, in assessing the evidence, DC Members have a wide margin of discretion. What one DC Member regards as establishing a fact on the balance of probabilities may be insufficient for another DC Member. This may be because they have different views about the credibility of a particular source or about the inferences that may properly be made from the primary facts. There may also be facts which some DC Members are prepared to accept without evidence, on the basis that they are notorious (referred to in legal proceedings as taking "judicial notice"), while other DC Members are not. Provided that each DC Member acts in a "commercially reasonable manner", there can be no objection to the existence of a range of views.

As well as helping DC Members to understand these principles, such guidance may also encourage the DCs to adopt a less risk-averse approach. Some of the comments made in the consultation process suggest that there may be a perception that, if the DC decides that certain facts exist that can subsequently be proved not to exist (or vice versa), an error has been made. However, that is not the case. Assessments of facts on the basis of incomplete evidence involve an exercise of judgment and it is plainly not the case that, if additional evidence clarifies the position, there was a failing in the original judgment.

8.3 DC objectives

One of the questions we were asked to consider was whether there should be a "mission statement" setting out the overall goal of the DCs and possibly ranking the DCs' objectives. A number of consultees did express view about the issues they considered to be important (specifically, the accuracy of decision-making, the speed and integrity of the process and, to a lesser extent, the costs involved), which are discussed in more detail elsewhere in this Report. However, consultees did not suggest that these goals should be formally ranked and nor do we think that an attempt to do so would be sensible. Simply placing the goals in an order of priority would be of little value without an indication of the weighting that should be given to a higher order position, yet the appropriate weighting must depend on the circumstances.

That said, we can see the benefit of setting out certain principles that the DCs should normally follow and there was some support amongst consultees for such an approach. For example, it was suggested that there may be value in stating the principle that decisions should be reached, and announced, as speedily as possible (provided that this does not compromise accuracy). A principle that the procedures followed by DCs, and the reasons for their decisions, should be transparent to market participants might also be included. It was suggested that, although these matters (if not addressed by particular rules) are within the control of the DCs anyway, articulating them as principles would help to focus the minds of the individuals in question.

If this approach is adopted, however, it should be made clear that any principles that are set out operate merely as a guide. They should not be treated as specific requirements that must be adhered to in all cases.

9 Transparency

9.1 Process transparency

One of the criticisms made by buy-side consultees is that the DC process is not as transparent as it should be. We agree that there is a lack of clarity about when a question will be accepted by a DC and, in paragraph 6.3 above, we suggested that there should be clear guidance about what information must be provided when raising an issue with the DCs.

The DC Rules already provide that, if the DC Secretary is asked to convene a DC, the request (together with any supporting information) must be published promptly on the DC website (unless the DC Secretary considers it to be substantially similar to another request)[1]. They also provide that, if a DC decides not to deliberate the relevant issue, this must be published promptly on the website.[2]

Buy-side consultees suggested that, if an issue is not deliberated by a DC, the reason for this should also be made clear (for example, that insufficient Publicly Available Information or other Eligible Information has been provided or the DC considers there to be is an insufficient volume of transactions to justify DC deliberations). We agree. As well as improving transparency, if the problem is due to a lack of Eligible information, this will enable other Eligible Market Participants to supply any further Eligible Information they have. If further Eligible Information is supplied (or obtained directly by the DCs), this should be posted on the DC website as soon as reasonably practicable after it has been received.

Various consultees noted that, when DC meetings are adjourned, there is often little information about the reason for the adjournment or when the matter is likely to be resolved. They suggested that there should be a better information flow from the DCs in these circumstances.

Where an issue is being actively considered by a DC and an adjournment takes place to enable the discussions to continue on a subsequent date, or because DC Members need time to think about the issues, we see very little scope for details to be provided about the status of the enquiry. We would not support a practice under which an announcement is made about any preliminary conclusions that may have been reached. It is unlikely to be practicable to make such an announcement because DC Members will not have expressed their views in the form of a vote. Any attempt to encapsulate the preliminary view may be difficult and would be likely to slow down the proceedings. More fundamentally, the announcement (which may be price-sensitive) could be misleading because the view might change and DC Members should not feel constrained by any announcement they might previously have made.

That said, there may be circumstances in which a DC can legitimately provide better information to market participants. For example, we have suggested that, if the DC is unable to decide from the Eligible Information available to it whether a Credit Event has occurred, it should be able to make a “not proven” determination and announce this immediately. However, if it does decide to adjourn a meeting pending the receipt of further Eligible Information, it should be willing to state publicly that this is the reason for the adjournment. On this point, we think the matter should be left to the discretion of the relevant DC. We do

[1] DC Rules, Section 2.5(d)(i)

[2] DC Rules, Section 2.5(d)(iv).

not think it is practicable for the DC Rules to set out the information that must be provided about any adjournment of a DC meeting.

9.2 Decision-making transparency

Buy-side members have suggested that sometimes insufficient information is provided about certain determinations made by the DCs. Although meeting statements are often published, particularly in relation to complex DC Credit Event Questions, practice differs across DC regions and, where statements are published, it has been argued that they do not always explain the reasons clearly enough. Furthermore, in the case of some decisions, including those to reject a proposed question or to dismiss a question, no reasons at all are provided.

Consultees we spoke to about this issue were generally in favour of DCs giving reasons for their decisions. However, one DC Member expressed reservations, on the basis that it would take too long to do, might be difficult for DC Members to agree a common statement and could provide a "road map" to criticise the DC.

In our view, there are strong arguments in favour of requiring the DCs to provide adequate reasons for all material decisions they take. It enables market participants that might have preferred a different conclusion to understand why the decision went against them and therefore perhaps make them readier to accept it. In any event, it confirms that the matter has been properly considered and promotes consistency in the decision-making process. These factors should promote confidence in the decision-making process and are particularly important in light of the composition of the DCs. By helping to focus the minds of the DCs, it may also improve the quality of decisions.

What constitutes adequate reasons will depend on the circumstances. If the matter is straightforward, a brief statement should be sufficient. More difficult decisions will require a longer explanation. It is not necessary to address every argument or, still less, all the points that were made in discussion. However, reasons should be provided in sufficient detail that market participants can understand why the decision was reached. The reasons can be provided after the decision is announced and so should not hold up the decision-making process. Although it would involve more work than merely announcing the decision, in our view this is part of the role that the DCs should be undertaking. Furthermore, if the DC is able to reach a decision, it should also be able to explain its reasons for doing so.

We do not think that a fear of providing a road map for criticism is an adequate justification for not providing reasons. It is certainly true that someone wishing to take issue with a decision may be able to base his or her criticism on the reasons provided rather than merely the outcome. However, the DCs should be open to criticism on that basis. In any event, this is a bridge that has already been crossed since, as noted above, detailed meeting statements are often published, especially by the Europe, Middle East and Africa DC.

We would also emphasise that the need for a statement of reasons is not necessarily confined to DC Credit Event Questions. For example, if the auction settlement terms are changed, an explanation of the reason for the change should be provided. As noted above, if the point is straightforward, the reasons can be simply stated. However, the fact that a non-legal decision has been taken does not justify the lack of an explanation.

10 Governance

10.1 Supervisory body

There was broad (although not unanimous) support amongst our consultees for the establishment of some form of governance body to oversee the operation of the DCs. At present, the Credit Steering Committee, established under ISDA's auspices, provides feedback on DC operations and requests changes to DC Rules where this is supported by market participants on the committee. However, it does not have a formal role.

We think it would be desirable to have a body with a formal role (set out in a set of rules) with responsibility for overseeing the way in which the DC carries out its functions. There are a number of reasons for this conclusion.

First, evaluation by a separate body about the performance of the DCs is more likely to produce an objective assessment than self-criticism by the DCs themselves. This enhances accountability, which is a key element of good governance practice. We recognise that there may be an overlap between the members of any governance body and the DC Members. However, they will be comprised of different individuals and will have complementary roles.

Secondly, whereas the individual DC representatives are lawyers, we would expect any governance body to be comprised of individuals with a wider skill set. They may, for example, be business representatives with experience of credit derivatives and/or compliance professionals. This would reflect the different roles carried out by the DCs and the governance body respectively. Combining two distinct roles within a single committee does not achieve an optimal result.

Thirdly, we would expect a governance body to report periodically to market participants about its findings relating to the workings of the DCs and obtain feedback from market participants. Whereas the DCs can (and do) consult from time to time, we think a structure which is specifically designed to achieve this is more likely to be effective. Amongst other things, we would expect the governance body to keep funding considerations under review, carry out value for money assessments periodically and report to the market accordingly.

Finally, we think that a governance body with a structure that is designed to obtain feedback from a range of market participants would be in a better position to identify the changes that need to be made to the DC determinations process (and otherwise) to achieve the goals desired by the market. To the extent that the governance body considers that changes need to be made to the DC Rules, we think that it should have the power to make the changes. In other words, changes to the DC Rules should be made by the governance body rather than the DCs themselves.

Not all the DC Members we spoke to were in favour of a governance body having power to make changes to the DC Rules. Some suggested that the DCs alone should have this power, on the basis that the DCs should not be bound by rules which they find unacceptable. Alternatively, they suggested that, if the governance body insisted on changing the DC Rules in a way which a DC Member considers unacceptable, the DC Member should be entitled to resign immediately.

We think it is important that DC Rule changes should be under the control of the governance body rather than the DCs as they set the standard for which the DCs should be required to account. The standard should be set by the body to which the DCs report. In practice, however, we would expect the governance body to make any changes to the DC Rules only in consultation with the DCs. The DCs' views are therefore likely to be very influential. We

would have no objection to it being agreed that a DC Member may resign if changes were made that the DC Member is unable to accept. However, it seems unlikely that such a confrontational approach would be adopted in practice.

One of our consultees expressed a concern that the creation of a governance body would merely create a more bureaucratic process, especially if its functions overlapped with those of other industry organisations, such as the Credit Steering Committee. In our view, however, this depends on how the proposals are implemented. The responsibilities of the governance committee need to be clearly set out and any overlaps with other industry bodies resolved. However, if this is done, we see no reason why the governance committee should be regarded as merely a bureaucratic inconvenience. On the contrary, if it has a clear role and performs the role effectively, it should add considerable value.

The details of the governance committee, including its composition, responsibilities and processes will need to be worked up separately. However, it is important that each of the main groups of market participants (including the buy-side and the sell-side, as well as clearing houses and service providers) are adequately represented. One buy-side consultee suggested that there should be a specific buy-side sub-committee to facilitate buy-side feedback and we can see the value in that suggestion.

10.2 Audits

One of the questions that will need to be addressed in determining the responsibilities of the governance committee will be the extent to which the committee should be able to require the compliance procedures of the DC Members to be audited. Although some DC Members told us that they would have no objection to this, the opposite view was expressed by others. Arguments against such a right of audit were that DC Members (especially the dealers) are heavily audited already and adding yet another audit would be burdensome with little additional benefit. Concerns were also expressed about confidentiality, if it means giving a client or competitor insight into a DC Member's functions.

In our opinion, it would be highly desirable if there were independent audits of the policies and procedures applied by DC Members to address conflicts of interest and this view is shared by most of the regulators we spoke to. Any such audit would be carried out by an independent professional and so the concerns expressed about confidentiality should not arise. The benefit of such an audit is that it would provide third-party verification that DC Members are not being improperly influenced by their economic interests. As noted in paragraph 4.2.3 above, serious non-compliance with the required standards is the principal risk associated with the DC process. Without third-party verification of each DC Member's procedures, it is difficult to see how any other DC Member, or market participants more widely, can be sure that this risk will not come to fruition.

That said, we do not think views about the merits of a governance body should depend solely on the answer to this question. As noted in paragraph 4 above, there are ways of enhancing market confidence in the integrity of the decision-making process that do not depend on information barriers and other compliance procedures. If those techniques are widely used, a lighter touch approach to third-party verification may be justified.

11 The DC Secretary

The DC Secretary (currently DC Administration Services, Inc ("**DCAS**")) has the responsibilities set out in the DC Rules. These are essentially administrative in nature and in practice are performed by Allen & Overy LLP ("**A&O**") on its behalf or by individuals seconded from A&O to DCAS. A&O also provides legal services for the benefit of the DCs. For example, it may review documentation to assist the DCs to determine whether something qualifies as a Deliverable Obligation or whether there is a Successor to a Reference Entity. It may also help a DC to understand the issues arising in connection with a DC Credit Event Question and may advise about any legal issues that arise. It may also arrange for any overseas advice required to be provided. This is all consistent with the DC Rules as they permit the DCs, DC Members or the DC Secretary to hire outside counsel or other professionals "to assist in the performance of their respective duties under the Rules".[1]

In general, the consultees we spoke to were comfortable about this combination of roles. However, one consultee commented that A&O has "control over the process from start to finish" and another suggested that there is not enough clarity under the DC Rules about the extent of its participation. It was suggested that the role of the DC Secretary and that of external counsel should be made clearer and that whether A&O is advising the relevant DC or DCAS should also be clarified.

We agree that the DC Secretary (in its capacity as such) has a significant degree of control over the administrative processes of the DCs. However, that is the role it has been asked to perform and is an essential part of the DC arrangements. As discussed in paragraphs 6.3 and 9.1 above, certain aspects of the DC process are not as clear as they could be and so require a degree of discretion on the part of the DC Secretary. However, this can be addressed by the measures discussed in those paragraphs. We do not think the fact that the DC Secretary has control over the DCs' administrative arrangements can be avoided or that it would be desirable to attempt to do so.

Slightly different issues arise in connection with the provision of legal advice relating to a DC Question. This is not part of the administrative services provided by the DC Secretary but we see no objection to the DCs appointing legal advisers (including A&O) to assist them in this way. As long as the assistance is limited to the provision of advice and does not, in substance, involve the DCs delegating the decision to a third party, the DC objectives should be achieved. For example, there should be no objection to legal advisers preparing a summary of the material facts and identifying the key issues that arise, or even expressing a view about how the issues should be resolved, provided that any points on which there is scope for a difference of views are clearly identified for a decision to be taken on them by the relevant DC.

That said, we do think that the DC Rules could be clearer about the capacity in which these services are provided. We think that the DC Rules should set out a non-exclusive list of the types of legal service that may sought by the DCs and make it clear that any such advice is provided by the law firm in question (acting in its capacity as such) to the DCs, rather than to DCAS.

A related observation made by one consultee was that it is unclear whether conversations outside of DC meetings between DC Members and legal advisers appointed by the DC or

[1] DC Rules, Section 2.5(e).

such DC Members are permitted. We do not think there is any objection to such conversations taking place and suggest that this should be expressly stated in the DC Rules.

Finally, one consultee suggested that, where legal advice is obtained, this should be disclosed by the DC (or the advice made publicly available). This is said to be desirable in the interests of transparency. In our view, however, the interests of transparency are served by ensuring that adequate reasons are given for the relevant decision. We doubt that disclosing the fact that advice was obtained on the point would add much, especially if the substance of the advice is not disclosed. We also do not think the DCs or DC Members should be required to waive the legal privilege that would otherwise apply.

12 Funding

12.1 Funding model

Funding for the DCs' activities is currently provided by the dealer members of the DCs. As well as bearing the overhead costs associated with contributing to the decision-making process, they have to make a significant contribution towards out-of-pocket expenses. The benefits, on the other hand, are enjoyed by all market participants. All the consultees with which we discussed this issue recognised it as inequitable (notwithstanding that dealers have the opportunity to make a profit from their participation in any Auctions). The challenge, however, is to find a funding model that both achieves a more equitable sharing of costs and can be implemented in practice.

This challenge is accentuated by the fact that dealer participation in the DCs has fallen in recent years. At the same time, the recommendations set out in this report will require some additional funding. Without adequate funding for the DCs and an appropriate funding model, some of the enhancements discussed in this report may not be possible and, in the long term, the effectiveness of the DCs may be compromised.

It appears to us that funding for the DCs would ideally come from a levy on individual transactions (including both index and single name transactions). This would result in the costs being borne by all market participants in proportion to the volume of transactions they enter into. There would still be a degree of unequal sharing as we would expect DC Members (other than any independent representatives) to continue to give their time free of charge. However, DC Members would not have to make disproportionate contributions to out-of-pocket expenses.

Some of the buy-side consultees we spoke to about this indicated that they would be amenable to some form of transaction-based charge. One buy-side entity, however, argued that the costs should be borne solely by the dealers, on the basis that they are the main beneficiaries of the arrangements. It argued that the principal benefit of the DC process is to avoid mismatches between offsetting positions and it is the dealers that hold the majority of these positions. It also argued that, whereas dealers predominantly enter into CDS transaction to make a dealing profit, buy-side firms tend to use the product to hedge risk or take an investment view.

We are not persuaded by these arguments as the benefits of the DC process are not limited to the avoidance of settlement mismatches. As discussed in paragraph 2.1 above, the benefits are much wider and accrue, directly or indirectly, to all market participants. This is the case whether the economic benefit provided by a CDS transaction is in the form of a dealing profit, an investment return or the hedging of risk.

Even if the principle of a transaction-based levy were accepted, however, implementing it is unlikely to be free of difficulty. One possibility would be to impose a levy on cleared transactions. However, that would result in the costs being borne solely by the cleared market. For this to be an equitable model, there would have to be a mechanism for levying a charge on the uncleared segment of the market. Another possibility would be to levy a charge at trade warehouse level (on the basis that the vast majority of CDS transactions are recorded in this way). However, there would need to be a mechanism to ensure that the charge is applied to the right transactions (for example, novations and compressions would need to be excluded).

A simpler model would be for the costs to continue to be borne by the dealers but on the basis that contributions are expected from a wider range of dealers (such as all index market makers), in proportion to the volume of their trades. We would expect such dealers to be willing to contribute if the costs were fairly apportioned but such a contribution could also be made a condition of providing dealers with full access to the DC website and other DC facilities, including participation in Auctions.

We are not in a position to be able to resolve these issues as a variety of operational and other issues will need to be addressed. However, we recommend that there is a wider consultation with market participants about the principles set out above and that, in light of the results of that consultation, a working group is established to work up a detailed proposal.

12.2 Budget management

If funding is obtained from sources other than DC Members (whichever funding model is used), there will need to be system of accounting for the use of the funds. We anticipate that market participants that contribute to the costs will expect reassurance that expenditure has been well managed. This is less of an issue at present because the funding is provided solely by dealer members of the DC. As noted in paragraph 10.1 above, however, if a governance committee is established, we would expect the committee to establish a process for the management of costs.

13 Admissibility of private information

One topic raised by a number of consultees was the extent to which the DC should be entitled to consider information that is not in the public domain and cannot be made public by being published in the DC website, i.e. that is not Eligible Information. This question arises in a number of contexts.

First, the instruments that qualify as Deliverable Obligations can include loans (and "Relevant Guarantees" in respect of them) ("**Loans**").[1] These are typically privately negotiated and, while the existence of a Loan may be in the public domain, its terms may not. Without access to information about the terms of the Loan, the DC may be unable to determine whether the Loan is a Deliverable Obligation and will therefore be unable to include the Loan on the list of Deliverable Obligations used for any Auction that is held.

This could be said to be an undesirable outcome because, where physical settlement takes place, the Buyer may specify a Loan in its Notice of Physical Settlement. The fact that the Loan is a private instrument is not necessarily an impediment because the terms of many Loans permit a holder of the Loan to disclose the Loan documentation to a potential transferee. The consequence is that, whereas a Loan may be used for the physical settlement of a CDS, it may have to be excluded from any Auction. If the Loan is the "cheapest to deliver" Deliverable Obligation, this would create an economic difference between the two settlement methods, as well as preventing a Buyer from delivering the Loan under the Auction settlement terms. It therefore limits the extent to which a CDS can be used to hedge credit risk under a Loan.

Secondly, a number of Credit Events depend on certain events occurring in respect of an "Obligation". If the terms of the Loan are not in the public domain, the DC may be unable to determine whether it is an Obligation for these purposes. This is an issue where Obligation Characteristics have to be satisfied or the question is whether a guarantee provided by the Reference Entity is a Relevant Guarantee. In this respect, however, the position is no different from bilateral settlement arrangements as, if the Buyer cannot cite Publicly Available Information confirming the relevant terms, it will be unable to provide a Notice of Publicly Available Information which confirms that a Credit Event has occurred.

Thirdly, whether a Reference Entity has a Successor (and, if so, the number of Successors) depend on whether another entity has succeeded to a specified proportion of the Reference Entity's "Relevant Obligations". This term comprises certain Obligations of the Reference Entity (either directly or as provider of a Relevant Guarantee) that fall within the "Bond or Loan" Obligation Category. In the case of a guarantee, the DC will need access to Eligible Information to determine whether it is a Relevant Guarantee. In this respect, however, the position is the same as it would be if the question were not referred to the DC as, in such circumstances, the determination must be made by the Calculation Agent, on the basis of Eligible Information.[2]

In principle, it would be possible to address these issues via an arrangement under which (if permitted by the Loan terms) the documentation is reviewed by an organisation such as a law firm without being made publicly available. The DC Rules could provide that a confirmation from such an organisation that the relevant criteria are satisfied could be used in lieu of Eligible Information. The main difficulty with this proposal, however, is that it would

[1] 2014 Definitions, Section 3.13(a)(v).

[2] 2014 Definitions, Section 2.2(b).

require reliance to be placed on the judgment of one organisation, on a point which could be of critical importance and in relation to which views may differ, without any mechanism for challenging its findings. As the terms would be confidential, full reasons for the decision could not be given.

It also raises wider issues about the design of a standard CDS transaction and the extent to which the market should facilitate its use as a hedge for a loan. This is a commercial question, the answer which potentially has an impact on the drafting of the 2014 Definitions. It is also the case that the appointment of a verification agent is not the only way in which the problem can be addressed. For example, the standard loan documentation could require the borrower (or a third party on its behalf) to certify that the relevant criteria are satisfied. Any such certification would be Eligible Information and so issues about transparency should not arise.

As the issues that arise are wider than the operation of the determinations process, we do think it would be right to try to tackle them as part of the current review. They should instead be addressed as part of a wider product review.

14 Website

One comment that was made by a large number of consultees is that improvements need to be made to the DC website. We share that view. Even a casual observer can see information presented on the website is not presented in a user-friendly manner or in a way which is easy to navigate. To a certain extent, this is a function of the way in which the DC Rules are drafted. For example, it is not possible to provide additional information relating to a DC Question without asking an entirely separate question. This should be replaced by a facility for Eligible Information to be added to an existing request (whether or not it has been accepted for deliberation by a DC), such that the up-to-date position is clearly visible on the website.

More generally, information about requests should be presented in a more user-friendly way and there should also be an index so that past issues considered by the DCs (and discussed in meeting statements) can be more easily identified, There should also be a facility to enable market participants to receive an alert if new information is posted on the website.

15 Proposals for consultation

The key recommendations which we consider should be put forward for consultation are set out below. In Appendix 2, we summarise various other recommendations, which can be addressed as part of a separate exercise.

	Recommendation	Paragraph references
1	**Addressing conflicts of interest**	
	We recommend that the DC Rules are changed to: • provide for the appointment of up to three independent members of the DCs (with one acting as DC chairman); • enhance the minimum requirements regarding DC members' compliance procedures; and • permit the DCs, by a simple majority, to refer DC Questions to an independent panel for a decision.	4.3, 4.4.1 and 5.3
2	**DC composition**	
	We recommend that: • the number of dealer members of the DCs is reduced to eight and the number of non-dealer members of the DCs is reduced to four (in addition to the CCPs and any independent members); • the eligibility threshold to serve as a non-dealer DC Member is reduced; • a non-dealer should be able to volunteer for membership of individual DCs, rather than having to join all the DCs; and • the provisions relating to consultative dealer and non-dealer members are removed.	4.5 and 4.6
3	**Governance** We recommend that a separate governance body is established, with responsibility for overviewing the operation of the DCs (including reporting to market participants and obtaining feedback from them) and making changes to the DC Rules from time to time (in lieu of the DCs). Views should be sought about whether the governance body should have the ability to appoint independent auditors to audit DC members' compliance procedures under the DC Rules.	10

4 Representation and transparency 7, 9.1 and 9.2

We recommend that the DC Rules are changed so that:

- Eligible Market Participants are entitled to present statements of case within certain parameters;
- any material step taken in the DC process (including any request to convene a DC, any statement of case submitted and any public information provided or obtained by the DC in connection with a DC Question) must be disclosed in the DC website as soon as is reasonably practical;
- the DCs and the DC Secretary are required to provide adequate reasons (stated on the DC website) for all material decisions they take.

Views should be sought about whether any statement of case may be provided in the name of a particular lawyer or law firm without disclosing the Eligible Market Participants that the lawyer or law firm represents.

5 Funding 12.1

We recommend that:

- views are sought about the appropriate funding model for the DCs (in particular, whether a transaction-based levy of some sort would be acceptable); and
- a working group is established to work up a detailed proposal in light of the result of that consultation.

Appendix 1
Topics on which feedback was sought

General Topics

1. Not including the substance of any decisions or auction mechanics, what are key aspects of how the DC operates and functions that currently work well and should be preserved?

2. Not including the substance of any decisions or auction mechanics, are there aspects of the DC operations that could be improved?

DC Functioning

3. Does the current composition of the DCs (e.g., number and criteria of buy-side and sell-side members, and the representatives of those firms, e.g., lawyers versus business members) as decision making bodies still provide the optimal structure for accomplishing the objectives of the DC? Is there another decision-making process that should be considered?

4. Please consider whether any proposals under Question 3 above would continue to maintain or bolster the strong, unconflicted protections existing today that ensure robust and transparent decision making, while avoiding any potential manipulation.

5. Does the current process for selecting members of the DCs still provide the optimal method of selecting DC members?

6. Should any changes be made to the formal DC decision process (including question acceptance, voting thresholds, and the external review process)? Please note any regional differences if relevant (e.g. external review panel composition).

7. Should there be any changes to the process for market participants to raise questions to convene the relevant DC, including considerations of any information that should or should not be included with a question?

8. Should any processes be added or changed to allow the DC to solicit market feedback on questions of CDS operations?

Governance/DC Rules

9. What should be the overall goal/mission of the DC, and what objectives should DCs aim for when considering questions (for example, establishing factual information for decisions, independence, speed, cost)? How should these objectives be ranked? Should objectives be explicitly stated, e.g. in a mission statement?

10. Does the current DC governance structure allow for appropriate adaptation to reflect changes in the CDS and underlying credit markets?

11. Should a separate body be established to enact changes to the DC Rules and have oversight of the DCs? If so, what should be the composition of such a body? Would this create any disincentives for firms to participate in the DC?

12. Should there be any formal governance procedure with regards to the role and interactions of the DC with individuals or market participants that are not on the DC (e.g. members of industry groups)? What form would this take?

Participation Disincentives

13. The costs of the DCs are currently entirely borne by the current dealer members of the DC. Is this a material disincentive for firms to join the DCs? Suggested changes to make the funding of the DC more robust and equitable across the CDS market.

14. Are there other material disincentives (e.g., reputational risk, legal or regulatory risk) for dealer or non-dealer firms to participate in the DCs? These could include time commitment, personnel commitment (including finding appropriate DC Representatives), or legal/regulatory/reputational risk. What changes should be made to address these disincentives?

15. Are there other incentives/criteria that should be considered for inclusion on the DCs?

Additional Comments

16. Any other changes or comments regarding the DCs.

Appendix 2
Other recommendations

	Recommendation	Paragraph references
1	**Applications for DC membership**	
	We recommend that it should be possible for applications for an unfilled DC position to be made outside the annual cycle.	4.5
2	**Asking a DC Question**	
	We recommend that the DC Rules:	6.3.2, 6.3.3 and 8.1
	• prescribe a checklist, in relation to each Credit Event, that identifies each of the elements that need to be evidenced and states whether Publicly Available Information or other Eligible Information is required;	
	• provide that, for a DC Credit Event Question to be valid, a completed checklist must be provided (together with the relevant Publicly Available Information or other Eligible Information) citing the document and page references on which any statements relied upon are made;	
	• provide that, if a DC Credit Event Question is ineffective due to a lack of Eligible Information, this must be specified on the DC website and that any Eligible Market Participant has a right to provide the missing information;	
	• permit the DCs to make a determination that it is "not proven" whether a Credit Event has occurred (following which any Eligible Market Participant would be entitled to provide additional Eligible Information in support of a subsequent decision that the Credit Event has occurred); and	
	• provide that a DC Question should be accepted automatically if certain criteria are satisfied (such as the Reference Entity being a component of a recognised index or the volume of outstanding transactions in respect of the Reference Entity exceeding a prescribed threshold).	
3	**DC deliberations**	8.2 and 11
	We recommend that the DC Rules state expressly that:	

- questions of contractual interpretation must be resolved by applying the relevant governing law (or an assumed governing law, which would depend on the region in question);
- questions of fact must be determined on the balance of probabilities; and
- conversations outside of Dc meetings between DC Members and legal advisers appointed by the DC or such DC Members are permitted.

4 Guidance

We recommend that a document is prepared which provides guidance to the DCs about the principles of interpretation that apply under English and New York law. 8.2

5 Recusal

We recommend that the DC Rules are changed to permit DC Members to recuse themselves from DC votes on conflict of interest grounds. 5.3

6 The DC Secretary

We recommend that the DC Rules clarify the way in which legal advice is provided and that legal advice may be obtained by individual DC Members outside DC meetings. 11