

EMEA DC Meeting Statement 8 April 2019

1. SUMMARY

- 1.1 The EMEA DC met on 8 April 2019 to discuss the approach to the Auction in relation to the Failure to Pay Credit Event in respect of Steinhoff Europe AG (the **Reference Entity**). The EMEA DC resolved to:
- (a) hold the Auction with respect to 2014 Transactions once the Reference Entity has fully implemented its CVA proposal; and
 - (b) apply the principle set out in Section 3.2(d) of the 2018 ISDA Credit Derivatives Determinations Committees Rules (the **DC Rules**) such that Representative Auction-Settled Transactions (**RASTs**) may be settled by delivery of the asset package resulting from the CVA in place of the relevant Deliverable Obligation. The asset package will be made up of the relevant tranches of the First Lien Loan and Second Lien Loan in the same proportion as results from the reconstitution of the relevant Deliverable Obligation.
- 1.2 The EMEA DC will provide further information about the Auction in due course. It is hoped that it will be possible to hold the Auction in May 2019.
- 1.3 The EMEA DC will publish the Initial List of the obligations of the Reference Entity that should constitute Deliverable Obligations in due course. To date, the only obligation that has been submitted for review is the €800,000,000 1.875% Notes issued by the Reference Entity due on 24 January 2025 (ISIN XS1650590349) and these Notes will be reviewed to assess whether they are deliverable by the EMEA DC. If any market participants have reason to believe that other obligations should ultimately be included on the Final List of Deliverable Obligations, they should submit any such obligations (with the required public copies of the documentation) by sending an email with all information required by the DC Rules to the DC Secretary (DCSecretary@cdsdeterminationscommittee.org).
- 1.4 As per the EMEA DC Meeting Statement of 22 March 2019, the Coverage Election in respect of the DC Question in relation to the Reference Entity was 2014 Transactions only and accordingly no Auction will be held in respect of Updated 2003 Transactions.

2. THE LOCK-UP AGREEMENT, COMPANY VOLUNTARY ARRANGEMENT AND IMPACT ON THE AUCTION

- 2.1 The Reference Entity has entered into a Lock-Up Agreement with a significant portion of its creditors. The Reference Entity stated in its proposal for a Company Voluntary Arrangement under the Insolvency Act 1986 (such arrangement, the **CVA**) that, as of 16 November 2018, the Lock-Up Agreement had been signed or acceded to by creditors representing approximately 96 per cent. of the Existing SEAG Debt (as defined in the CVA proposal). Amongst other things, the terms of the Lock-Up Agreement (i) restrict the transfer of debt that is subject to the Lock-Up Agreement to parties that are not party to the Lock-Up Agreement; and (ii) provide that any debt subsequently acquired by a person bound by the Lock-Up Agreement immediately becomes subject to it (subject to some exemptions).
- 2.2 The Reference Entity is also in the process of implementing the CVA which provides for the reconstitution of the Reference Entity's existing debt into tranches of a First Lien Loan and a Second

Lien Loan to be issued by Lux Finco 2. Pursuant to the terms of the CVA, the issue of the new debt will result in the satisfaction of the existing debt without the movement of any cash.¹

- 2.3 The Lock-Up Agreement and CVA therefore pose a number of challenges to holding the Auction ahead of the completion of the CVA and the Lock-Up Agreement falling away. The EMEA DC previously modified the Auction Settlement Terms in respect of the 2016 Credit Event in respect of Grupo Isolux Corsán Finance B.V., to enable an expedited Auction to be held whilst a restructuring agreement was in place.² However, the EMEA DC was of the view that it was not desirable to adopt this approach in respect of the Auction in respect of Steinhoff Europe AG because (i) even with an expedited timeline, settlement of the RASTs could still be disrupted by the completion of the CVA process and the reconstitution of the Deliverable Obligation(s); (ii) the lack of liquidity in relation to the non locked-up Deliverable Obligations of the Reference Entity may result in the RAST buy-in provisions producing values that are not reflective of the credit impairment of the relevant Deliverable Obligation(s); and (iii) imposing restrictions on the submission of Customer Physical Settlement Requests is not generally beneficial to the market as a whole and is more difficult to justify in circumstances where settlement of the RASTs may still be disrupted.
- 2.4 Whilst the EMEA DC recognised the need of the CDS market for efficiency and the swift settlement of outstanding CDS transactions in relation to Steinhoff Europe AG, the EMEA DC was of the view that the better approach was to hold the Auction once the CVA has been implemented and the Deliverable Obligations have been reconstituted. The delay to the Auction Date means that amendments to the Auction Settlement Terms of the sort required in relation to the Auction in respect of Grupo Isolux Corsán Finance B.V. will not be required in relation to the Auction in respect of Steinhoff Europe AG.

3. WHAT WILL BE DELIVERABLE IN SETTLEMENT OF RASTS

- 3.1 Section 3.2(d) of the DC Rules states that if the DC determines that the Credit Derivatives Auction Settlement Terms and Final List are not broadly reflective of the Deliverable Obligations and ability to settle which would have been available if Physical Settlement had been the applicable Settlement Method and that this would cause prejudice to either Buyer or Seller under a Relevant Transaction, the relevant DC may make amendments to the Credit Derivatives Auction Settlement Terms and/or Final List as applicable in an attempt to avoid or mitigate against such prejudice.
- 3.2 In the case of Steinhoff Europe AG, a protection buyer that was holding non locked-up debt that qualified as a Deliverable Obligation could have delivered such debt in settlement of a CDS transaction had Physical Settlement been applicable. Furthermore, a protection buyer who was not holding non-locked up debt would have a significant period of time to source such debt in order to deliver it. However, the delay necessary to hold an Auction will mean that the original Deliverable Obligations may be reconstituted into the relevant tranches of the First Lien Loan and Second Lien Loan in accordance with the terms of the CVA or at best the RASTs could be settled on an expedited basis which magnifies the settlement risk caused by the lack of liquidity in the non-locked up debt.
- 3.3 Accordingly, by application of the principle in Section 3.2(d) of the DC Rules, the Auction Settlement Terms should allow for RASTs to be settled by delivery of a package of the relevant tranches of the First Lien Loan and Second Lien Loan in the same proportion as resulted from the reconstitution of the relevant Deliverable Obligation. A similar approach was taken in relation to the 2016 Portugal Telecom International Finance B.V. Credit Derivatives Auction Settlement Terms. In that case, asset package delivery was permitted in respect of certain notes issued by the Reference

¹ See the original CVA Proposal dated 29 November 2018 and the amended CVA Proposal dated 28 March 2019 for more information.

² See <https://www.cdsdeterminationscommittees.org/cds/grupo-isolux-corsan-finance-b-v/>. The AEJ DC also modified the 2018 Noble Group Limited Credit Derivatives Auction Settlement Terms due to the presence of a restructuring support agreement (<https://www.cdsdeterminationscommittees.org/cds/noble-group-limited-4/>).

Entity due to redeem in July 2016 in the event that such notes were redeemed or exchanged in whole or in part due to the proximity of the scheduled maturity date of such notes and the potential delivery date of such notes under a RAST.

It is important to note that the application of Section 3.2(d) of the DC Rules is not the same as applying Asset Package Delivery under the 2014 Definitions. Unlike Asset Package Delivery, the Deliverable Obligations that are ultimately converted into an asset package must have survived the Credit Event and only been modified subsequently during the time lag for an Auction being held or settled.

- 3.4 The EMEA DC also considered whether the tranches of the First Lien Loan or Second Lien Loan could be deliverable as Deliverable Obligations in their own right. If this were true then protection buyers would be able to settle RASTs by delivery of the cheapest-to-deliver tranche of the First Lien Loan or Second Lien Loan. For this to be true, Lux Finco 2 as issuer of the new debt would need to be a Successor to the Reference Entity and the relevant new debt would have to satisfy all the Deliverable Obligation Characteristics. The EMEA DC has not verified whether any of the tranches of the First Lien Loan or Second Lien Loan would satisfy the Deliverable Obligation Characteristics. Moreover, under section 3.14 of the 2014 Definitions, the Deliverable Obligation Characteristics must be satisfied on the NOPS Effective Date and the Delivery Date. The NOPS Effective Date cannot be later than the NOPS Cut-off Date which falls on 19 April 2019 in relation to the Steinhoff Europe AG Credit Event. Therefore, it will only be possible for the new First Lien Loan and Second Lien Loan (or any tranche thereof) to constitute Deliverable Obligations in their own right (as opposed to as part of an asset package under Section 3.2(d) of the DC Rules) if the CVA is completed and the debt reconstituted by 19 April 2019. This appears very unlikely as the Notice of the CVA Effective Date dated 1 April 2019 in respect of the Reference Entity stated that the Reference Entity was still working towards satisfying the Implementation Conditions detailed in the CVA.