13 September 2019

2019 Steinhoff Europe AG Credit Derivatives Auction Settlement Terms

Explanatory statement

1. SUMMARY

1.1 This note summarises the approach taken in the draft 2019 Steinhoff Europe AG Credit Derivatives Auction Settlement Terms (the **Draft ASTs**)[1] to ensure efficient operation of the Auction in light of the debt restructuring of Steinhoff Europe AG (the **Reference Entity**). This note should be read in conjunction with the Draft ASTs and the Initial List.

1.2 The Draft ASTs and the Initial List have been published today, September 13, 2019. The public comment period in relation to the ASTs expires at 5.00 p.m. London time on September 20, 2019. The period for Eligible Market Participants to submit additional obligations for inclusion on the Supplemental List ends at 5:00 p.m. London time on Monday 16 September 2019. Please contact the DC Secretary at DCSecretary@cdsdeterminationscommittees.org with any comments on the Draft ASTs or any such obligations.

1.3 Capitalised terms used but not defined herein have the meanings given to them in the Draft ASTs (including in the 2014 ISDA Credit Derivatives Definitions and the 2018 ISDA Credit Derivatives Determinations Committees Rules (the **DC Rules**)).

2. BACKGROUND

2.1 The DC has previously resolved that a Failure to Pay Credit Event occurred on 8 February 2019 with respect to 2014 Transactions (the Coverage Election in respect of the original DC Question was 2014 Transactions only, so no determinations have been made in respect of Updated 2003 Transactions).

2.2 The Reference Entity has now implemented its proposal for a Company Voluntary Arrangement under the Insolvency Act 1986 (such arrangement, the **CVA**). Upon the implementation of the CVA, the existing debt obligations of the Reference Entity were reconstituted into tranches of a First Lien A1 Loan and a Second Lien A2 Loan where the Borrower is Steenbok Lux Finco 2 S.À.R.L.. The debt obligations so reconstituted include the €800,000,000 1.875% Notes issued by the Reference Entity due on 24 January 2025 (ISIN XS1650590349) (the **Notes**). Based on what has been submitted to the DC, the Notes previously constituted the sole Deliverable Obligation of the Reference Entity. Pursuant to the terms of the CVA, the issue of the new debt resulted in the satisfaction of the existing debt without the movement of any cash.[2]

3. PREVIOUS DC RESOLUTIONS REGARDING AUCTION

3.1 The DC previously made a number of resolutions in relation to the Auction process in light of the then proposed restructuring of the sole Deliverable Obligation in respect of the Reference Entity. For more information and further discussion of the issues considered by the DC, see the EMEA DC Meeting Statements of 22 March 2019[3] and 8 April 2019[4].

Auction to take place post-CVA implementation

3.2 At the time of the Credit Event determination, it was not clear when the CVA and resulting debt reconstitution would take effect. Further, there was in place a lock-up agreement in respect of a

[1] Available at https://www.cdsdeterminationscommittees.org/documents/2019/09/emea-dc-draft-steinhoff-asts-13-09-19.pdf
[2] See the latest CVA Proposal for more information, available at https://www.lucid-is.com/steinhoff/
[3] Available at https://www.cdsdeterminationscommittees.org/documents/2019/03/emea-dc-statement-22-03-19.pdf
[4] Available at https://www.cdsdeterminationscommittees.org/documents/2019/04/emea-dc-statement-8-april-2019.pdf

significant portion of the Reference Entity's debt. The DC wished to avoid the possibility of the debt reconstitution taking place during the settlement period for Representative Auction-Settled Transactions (**RASTs**), and the lock-up agreement affecting Auction liquidity and/or requiring restrictions on the submission of Customer Physical Settlement Requests. Accordingly, the DC resolved to hold the Auction with respect to 2014 Transactions once the Reference Entity has fully implemented its CVA proposal. This process was completed on 13 August 2019.

Application of Rule 3.2(d) to avoid prejudicing protection buyers

3.3 When the CDS market moved towards Auction Settlement as the standard form of settlement rather than Physical Settlement, one of the guiding principles was that, so far as possible, market participants should not be prejudiced by the change. So, for example, it would be unfair if there are good Deliverable Obligations that survive the occurrence of the relevant Credit Event – and so the CDS trade could have been immediately physically settled – but these obligations have disappeared by the time the Auction takes place. So the DC may seek to avoid this prejudice by expediting the Auction so that Auction Covered Transactions may be settled whilst the relevant Deliverable Obligations are still available, or by making appropriate amendments to the Auction Settlement Terms. This approach is anticipated in Section 3.2(d) of the DC Rules.

3.4 In this case, when compared to the situation that would have prevailed had physical settlement applied, the delay to settlement risked prejudicing protection buyers. Had physical settlement been applicable, a protection buyer that was holding a non-locked up Deliverable Obligation could have delivered such debt in settlement of a CDS transaction (or, were it not holding such debt, would have had sufficient time to source then deliver it). The delay to settlement as a result of the decision to hold the Auction only once the Reference Entity had fully implemented its CVA proposal prejudices this: the original Deliverable Obligation(s) that a protection buyer could have delivered no longer exist, and have been replaced by debt obligations that would not constitute Deliverable Obligations in respect of the Reference Entity.

3.5 Accordingly, the DC resolved to apply the principle set out in Section 3.2(d) of the DC Rules. This states that, if (i) 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 (ii) 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.

4. APPLICATION OF RULE 3.2(D) TO THE AUCTION

4.1 The DC therefore resolved that the Auction Settlement Terms should allow for RASTs to be settled by delivery of a package of the relevant tranches of the First Lien A1 Loan and Second Lien A2 Loan in the same proportion as resulted from the reconstitution of the relevant original Deliverable Obligation (i.e. the Notes). This package of assets reflects the cash-market position of a holder of the Notes immediately following the reconstitution and, therefore, the package of assets that a protection seller would at such time have received had delivery of the Notes been effected under the usual physical settlement timeline. The precise proportions are set out in the notes to the Initial List (and will be repeated on the Supplemental List and Final List once published), and are taken from Annex 17 to the Reference Entity's amended and restated company voluntary arrangement dated 12 July 2019[5].

4.2 Further, part of the principal amount of each of the First Lien A1 Loan and Second Lien A2 Loan comprises capitalised defaulted interest in respect of the Notes. Such portion should be taken into

[5] Available at https://www.lucid-is.com/wp-content/uploads/2019/07/SEAG12719.pdf

account when valuing the package of Deliverable Obligations for purposes of determining the Auction Final Price, as it would have become due to a holder of the Notes immediately following the reconstitution, and so reflects the cash position that a protection seller would experience had they received delivery of the Notes under the usual physical settlement timeline. Accordingly, where Participating Bidders value the relevant package of Deliverable Obligations based on a given Quotation Amount, delivery in settlement of any resulting RASTs will be satisfied by delivery of the First Lien A1 Loan and Second Lien A2 Loan (in the relevant proportions) with an aggregate principal amount equal to the product of (i) the relevant Quotation Amount and (ii) 1.07908512. The DC understands that this is the ratio that reflects the principal amount of First Lien A1 Loan and Second Lien A2 Loan that a holder would have received had they held a given principal amount of the Notes prior to the reconstitution.

4.3 By allowing delivery of the package of assets in the amount and proportions set out above following the Reference Entity's debt reconstitution, the standard CDS contract behaves in a manner broadly consistent with the outcomes that would have occurred had physical settlement applied. Note that this approach is not the same as Asset Package Delivery under the 2014 Definitions, which does not apply to the Transaction Type applicable to the Reference Entity (which is Standard European Corporate). The critical distinction is that Section 3.2(d) of the DC Rules is only concerned with situations where Physical Settlement *would* have been applicable to protection buyers had it been the applicable Settlement Method. In other words, the relevant Deliverable Obligation *must* have survived the occurrence of the Credit Event. By contrast, the Asset Package Delivery provisions only require that a Deliverable Obligation existed prior to the occurrence of the relevant Credit Event.

4.4 The DC noted that there were certain other fees potentially due to creditors under the CVA (e.g. fees for acceding to the lock-up agreement early, roll-over fees and maturity fees), but these were either not, or not necessarily, due to a person who held the Notes at the time physical settlement would have occurred, and so should not be factored into the approach to the Auction.

4.5 To summarise the approach by way of a worked example, a person that was holding Notes with an outstanding principal amount of EUR 1,000,000 immediately prior to the debt reconstitution would, immediately after the reconstitution, be holding a package of (i) the First Lien A1 Loan in a principal amount of EUR 369,561.80 and (ii) the Second Lien A2 Loan in a principal amount of EUR 709,523.32. Accordingly, in relation to a RAST with a Floating Rate Payer Calculation Amount of EUR 1,000,000, settlement thereof will be achieved by delivery of both (i) the First Lien A1 Loan in a principal amount of EUR 369,561.80 and (ii) the Second Lien A2 Loan in a principal amount of EUR 709,523.32. Assuming therefore a Quotation Amount of EUR 1,000,000, this package is the obligation whose value will be determined under the usual Auction processes, and will therefore be the asset whose value determines the Auction Final Price.

5. DRAFT ASTS AND INITIAL LIST

Provisions to reflect the application of rule 3.2(d) to the Auction

5.1 The DC has introduced certain amendments in the Draft ASTs to the typical terms of EMEA DC Auction Settlement Terms in order to achieve this position. In particular, limb (h) of the definition of "Representative Auction-Settled Transaction" provides that the sole Deliverable Obligation for the purposes of settling RASTs is the package of Deliverable Obligations set out in the Final List, in the amount and proportions set out therein. The Initial List then reflects the position described above (such position to be restated on the Supplemental List and Final List when each of them is published; references in the Draft ASTs in general to the "Final List" should be construed as references to the Initial List for purposes of considering the published draft).

5.2 Further, the Draft ASTs make clear that a protection buyer's obligation to deliver the package of the First Lien A1 Loan and Second Lien A2 Loan is only satisfied once the relevant amount of both loans has been delivered.

Other points to note

5.3 There are a number of other points worth noting in relation to the Auction:[6]

(a) The terms of the First Lien A1 Loan and Second Lien A2 Loan each provide that a transfer or assignment of part of a Lender's participation in a Facility must be in an amount such that the amount of that Lender's remaining participation (when aggregated with its Affiliates' and Related Funds' participation) in respect of Commitments or Loans made under that Facility (taken together), if any, is in a minimum amount of EUR 1,000,000 unless: (i) the Existing Lender assigns or transfers all of its Commitment or Loans under that Facility; or (ii) the Existing Lender is Steenbok Stichting CVA (being the Holding Period Nominee). Participants should arrange their participation in the Auction accordingly.

(b) The terms of the First Lien A1 Loan and Second Lien A2 Loan also provide that the transferee is liable for a fee to the relevant Agent of EUR 3,500 per loan. The Draft ASTs preserve this position (see limb (l)(xxvi) of the definition of "Representative Auction Covered Transaction").

(c) In accordance with the Draft ASTs, neither Deliverable Obligation need be delivered in accordance with any market advisory. Each Deliverable Obligation shall be delivered in accordance with its terms and parties will not be required to enter into additional LMA Secondary Debt Trading Documentation.

(d) The definition of Market Position (being the cumulative risk position of a Participating Bidder or customer in terms of its Auction Covered Transactions and Auction-Linked Cash Settled Transactions, and hence the term that defines the size and nature of physical settlement requests that a participant can submit) includes reference to determining the relevant risk profile without regard to whether relevant trades are cash or physically settled. However, the trades that comprise the relevant risk profile are by definition cash settled. This reference has been removed as a tidy-up.

[6] Capitalised terms in this paragraph have the meanings given to them in the draft documentation for the First Lien A1 Loan and Second Lien A2 Loan, available at https://www.lucid-is.com/steinhoff/