

**TO:** File

**FROM:** Kim Allen

**RE:** Meeting between Staff in the Division of Trading and Markets and representatives of the International Swaps and Derivatives Association (ISDA)

**DATE:** November 14, 2013

On November 7, 2013, Katherine Darras and Chris Young of ISDA met with the following staff from the Division of Trading and Markets: Greg Berman, George Gilbert, Jeffrey Mooney, Gena Lai, Wenchi Hu, Michael Gaw, Stephanie Park, Brian Bussey, Katherine Martin, Tim Fox, Laura Compton, Justin Byrne, Marc Leibert, Max Polonsky, Joshua Kans, Carol McGee, Margaret Rubin, Teen Sheng, Tom Eady and Kim Allen. The topic of the meeting was the 2011 ISDA equity derivatives definitions and the related matrices for individual product types ISDA is developing. Presentation materials were provided to SEC staff at the meeting. A copy of such presentation materials is included with this memorandum.



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Markets

# **2011 ISDA Equity Derivatives Definitions**

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# 2011 ISDA Equity Derivatives Definitions

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- The 2011 ISDA Equity Derivatives Definitions (**2011 Definitions**) are more than a simple update of the 2002 ISDA Equity Derivatives Definitions (**2002 Definitions**).
- A **new architecture** was developed for the 2011 Definitions and the confirmation of equity derivative transactions.
- The 2011 Definitions adopt an **innovative, open, modular** approach.
- Considerable **functionality** has been added compared to the 2002 Definitions.

# Overview of MCAs and GTCs

2004	2005-2006	2007	2008	2009-2010
<ul style="list-style-type: none"> <li>• 2004 US Interdealer Master EQD CA               <ul style="list-style-type: none"> <li>- Annex IO</li> <li>- Annex IS</li> <li>- Annex SO</li> <li>- Annex SS</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• 2005 JPY Interdealer Master EQD CA               <ul style="list-style-type: none"> <li>- Annex IO</li> <li>- Annex SO</li> </ul> </li> <li>• AEJ Interdealer Master EQD CA               <ul style="list-style-type: none"> <li>- Annex IO</li> <li>- Annex IS</li> <li>- Annex SO</li> <li>- Annex SS</li> </ul> </li> <li>• 2006 JPY Interdealer Master Variance Swap CA               <ul style="list-style-type: none"> <li>- Annex IVS</li> <li>- Annex SVS</li> </ul> </li> <li>• Revised 2004 US Interdealer Master EQD CA               <ul style="list-style-type: none"> <li>- Annex IO</li> <li>- Annex IS</li> <li>- Annex SO</li> <li>- Annex SS</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• 2006 JPY Variance Swap CA               <ul style="list-style-type: none"> <li>- Annex IVS</li> <li>- Annex SVS</li> </ul> </li> <li>• Standalone 2007 US Variance Swap               <ul style="list-style-type: none"> <li>- Annex IVS</li> <li>- Annex SVS</li> </ul> </li> <li>• 2004 US Interdealer Master EQD CA               <ul style="list-style-type: none"> <li>- Annex IVS</li> <li>- Annex SVS</li> </ul> </li> <li>• Revised 2005 AEJ Interdealer Master EQD CA               <ul style="list-style-type: none"> <li>- Annex IO</li> <li>- Annex IS</li> <li>- Annex SO</li> <li>- Annex SS</li> </ul> </li> <li>• Revised 2007 EU Variance Swap CA               <ul style="list-style-type: none"> <li>- Annex IVS</li> <li>- Annex SVS</li> </ul> </li> <li>• Amended 2007 EU EQD CA               <ul style="list-style-type: none"> <li>- Annex ISO</li> <li>- Annex IS</li> <li>- Annex SS</li> <li>- Annex EFS</li> </ul> </li> <li>• 2007 AEJ Variance Swap CA               <ul style="list-style-type: none"> <li>- Annex IVS</li> <li>- Annex SVS</li> </ul> </li> <li>• 2007 EU Variance Swap CA               <ul style="list-style-type: none"> <li>- Annex IVS</li> <li>- Annex SVS</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• 2008 AEJ Master EQD CA               <ul style="list-style-type: none"> <li>- Annex OMISO</li> <li>- Annex OMEFS</li> <li>- Annex OMIS</li> </ul> </li> <li>• 2008 EU Dispersion Variance Swap               <ul style="list-style-type: none"> <li>- Annex DVS</li> </ul> </li> <li>• 2008 JPY Master EQD CA               <ul style="list-style-type: none"> <li>- Annex IO</li> <li>- Annex SO</li> </ul> </li> <li>• 2008 JPY Dividend Swap MCA               <ul style="list-style-type: none"> <li>- Annex IDS</li> </ul> </li> <li>• 2008 US DC/ETC CA               <ul style="list-style-type: none"> <li>- Annex A</li> <li>- Annex B</li> </ul> </li> <li>• EU Var Option Appendix               <ul style="list-style-type: none"> <li>- Annex IVO</li> <li>- Annex SVO</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• 2<sup>nd</sup> Revised 2007 AEJ Master Var. Swap CA               <ul style="list-style-type: none"> <li>- Annex IVS</li> <li>- Annex SVS</li> </ul> </li> <li>• Revised 2008 AEJ Master EQD CA               <ul style="list-style-type: none"> <li>- Annex OMISO</li> <li>- Annex OMEFS</li> <li>- Annex OMIS</li> <li>- Annex CMISO</li> </ul> </li> <li>• 2<sup>nd</sup> Revised 2005 AEJ Interdealer M. EQD CA               <ul style="list-style-type: none"> <li>- Annex IO</li> <li>- Annex IS</li> <li>- Annex SO</li> <li>- Annex SS</li> </ul> </li> <li>• Revised 2007 AEJ Master Var. Swap CA               <ul style="list-style-type: none"> <li>- Annex IVS</li> <li>- Annex SVS</li> </ul> </li> <li>• Annex IS and CSIA to 2007 EU M. EQD CA</li> </ul> <ul style="list-style-type: none"> <li>• 2009 EU Interdealer Master EQD CA               <ul style="list-style-type: none"> <li>- Annex SS</li> <li>- Annex ISO</li> <li>- Annex FVSS</li> <li>- Annex FVIS</li> <li>- Annex IIS</li> </ul> </li> <li>• 2009 US M. EQD CA               <ul style="list-style-type: none"> <li>- Annex IS</li> <li>- Annex ISO</li> <li>- Annex CSSS</li> <li>- Annex ETCIO</li> <li>- Annex DCSO</li> </ul> </li> <li>• 2009 Pan Asia Interdealer M. EQD CA               <ul style="list-style-type: none"> <li>- Annex PAISS</li> <li>- Annex PAIIS</li> </ul> </li> <li>• Revised 2008 JPY Dividend Swap MCA               <ul style="list-style-type: none"> <li>- Annex IDS</li> </ul> </li> <li>• 2010 EMEA EM Interdealer M. EQD CA               <ul style="list-style-type: none"> <li>- Annex ISEMO</li> <li>- OCSIA</li> </ul> </li> </ul>

# Key Goals for the 2011 Definitions

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- **Consolidate** the 2002 Definitions, MCAs, GTCs and product annexes into a single documentation architecture.
- **Review and update** the trade and risk allocation provisions.
- Develop a documentation **architecture** that would facilitate and support:
  - further **standardisation** of legal terms;
  - development of **new products** and variations of existing products;
  - adoption of **transaction matrices**;
  - **electronic automation** and standardisation of **transaction processing**;
  - **electronic matching** and **transaction reporting**; and
  - conversion into **machine readable** form.



# Objectives of The 2011 Definitions

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- The 2011 Definitions are designed to support both fully electronic and paper documentation formats in order to facilitate the following policy objectives:

- **Standardization:**

**2002 Definitions:** Executed contracts are **not** standard. Each form reflects bilateral negotiated terms and conforms to house templates, which differ institution to institution. Word processors used to prepare bespoke agreements on a document-by-document basis. Terms based upon the 2002s are often amended across different MCAs, requiring a document-by-document review.

**2011 Definitions:** Executed contracts are standardized. Contracts are constructed off of a central database of definitions. No word processing of confirms results in full standardization of terms across the industry.

- **Real-time confirmations:**

**2002 Definitions:** Transaction Supplements are processed in a different manner and on a different timeline than Master Confirmation Agreements. MCA negotiations often occur during or after trades have been executed.

**2011 Definitions:** Because trades are confirmed using simple election sheets (if on paper) or through a central system (MarkitSERV), trades can be confirmed real-time – including the elections that would otherwise have been negotiated in an MCA.

# Objectives of The 2011 Definitions

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- **Golden Record:**

**2002 Definitions:** Lack of standardization across documents coupled with the use of paper agreements makes it impossible to establish a central database of terms. There is no transparency to the documentation pool – every agreement must be reviewed on a document-by-document basis.

**2011 Definitions:** A central database of terms facilitates the ability to house trade terms centrally for regulatory and risk management purposes. This database would provide complete transparency in regards to the terms of any trade documented under the 2011s.

# Amended 2002 Definitions – Non-standard Contracts

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- **MCAs:** Shortly after publication, significant amendments applied, first through the MCA process, then in the course of actual negotiation. **Result is that the 2002 Definitions MCAs no longer sit on a standardized platform.**
- Multiple versions of the same term (e.g., Change in Law).
- Trades must be manually reviewed on a confirmation-by-confirmation basis to determine what the terms are.

Exercise Period:	As specified in Section 3.1(a) of the Equity Definitions, excluding any day (other than the Expiration Date) on which american-style option contracts that trade on the relevant Share or Index on the Related Exchange cannot be exercised under the rules of the Related Exchange. If Exchange Look-alike applies, the text "9:00 a.m." referred to in Sections 3.1(a)(i) and 3.1(a)(iii) of the Equity Definitions is replaced by the words "the first time at which the Designated Contract may be exercised".
Exercise of European Options:	If notice of exercise of a European Option is given prior to the Exercise Period commencing, that notice is deemed given when the Exercise Period commences.
Latest Exercise Time:	If Exchange Look-alike applies and american-style exercise Designated Contracts exist, the last time at which those Designated Contracts may be exercised on the Related Exchange.  In all other circumstances for Share Transactions: (i) if Physical Settlement applies, thirty minutes after the Scheduled Closing Time of the Exchange; and (ii) if Cash Settlement applies, thirty minutes before the Scheduled Closing Time of the Exchange.
Expiration Time:	If Exchange Look-alike applies and Designated Contracts exist, the last time at which the Designated Contracts may be exercised on the Related Exchange.  In all other circumstances for Share Transactions, thirty minutes after the Scheduled Closing Time of the Exchange.
Amendment to Valuation Time:	If an Index Transaction has more than one Exchange, then, unless the Exchange is specified in the Transaction Supplement as "Multiple Exchange" and/or the Multiple Exchange Index Annex otherwise applies to the relevant Transaction, the Valuation Time (a) for the purposes of determining whether an Early Closure has occurred in respect of (i) any security in the Index is the Scheduled Closing Time on the Exchange in respect of such security, and (ii) options contracts or future contracts on the Index, is the close of trading on the Related Exchange; and (b) for all other purposes, is the time at which the official closing level of the Index is calculated and published by the Index Sponsor.  If a Strike Date is specified in a Transaction Supplement for a Transaction in respect of which the Multiple Exchange Index Annex does not apply, then Section 6.1 of the Equity Definitions shall be amended with respect to such Transaction by including the words ", Strike



# 2002 Definitions = 2011 Definitions

- **Original Design:** 1st Generation Confirmations designed for use with 2002 Definitions (contained no language, only elections)
  - Like the 2011s, 1<sup>st</sup> Generation 2002 Definitions confirms incorporated the definitions and applied its terms ***without amendment***.
  - In this respect, the 2011s are similar to the 2006 Definitions – rather than add additional rate definitions at the confirm level, for example, the Definitions themselves are updated with new terms. No confirm-level amendments.

EXHIBIT II-A  
to 2002 ISDA Equity Derivatives Definitions

**Additional Provisions for a Confirmation  
of a Cash-settled Index Option Transaction**

[See Exhibit I for the introduction, standard paragraphs and closing for the letter agreement or telex.]

2. The terms of the particular Transaction to which this Confirmation relates are as follows:

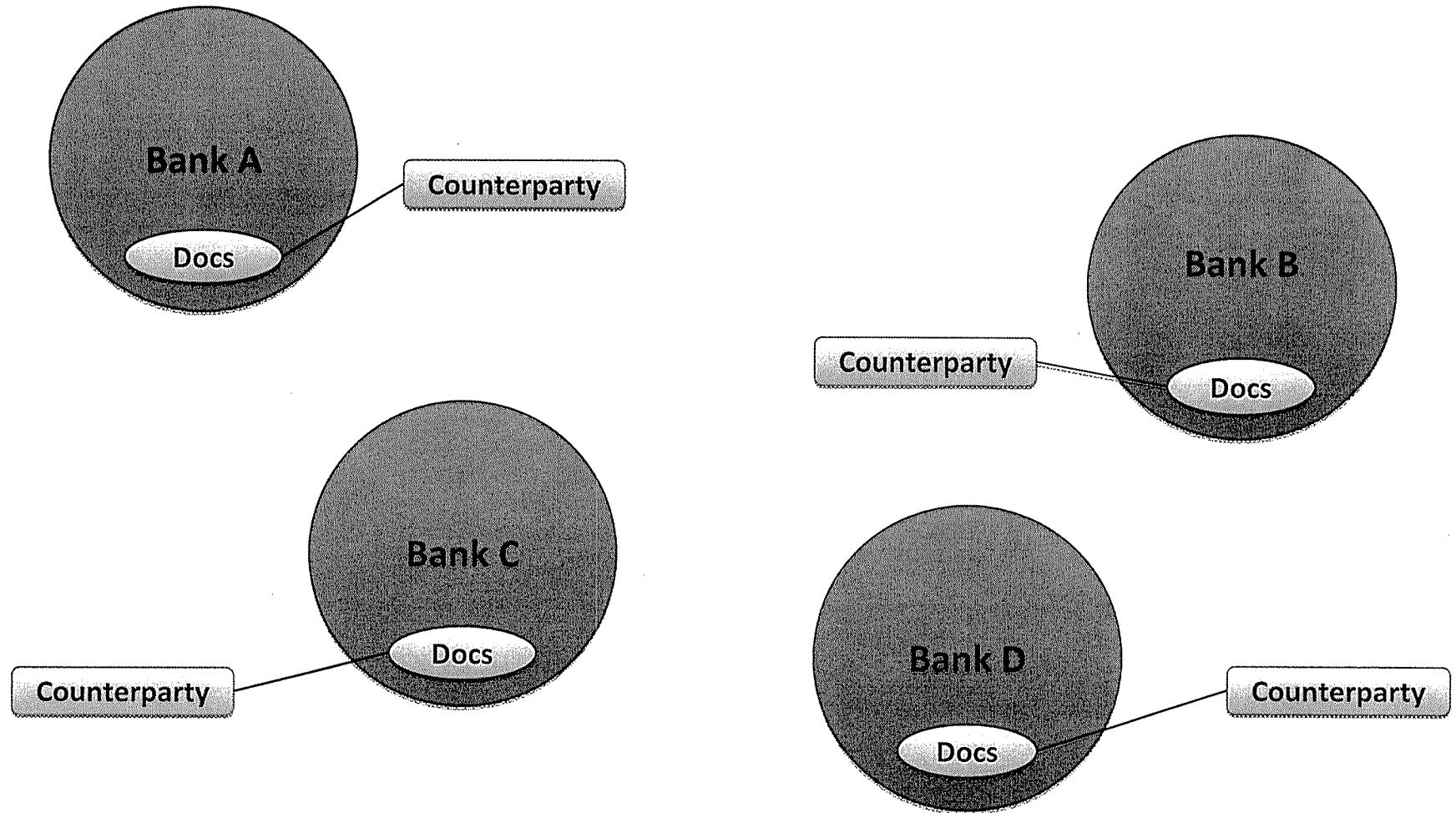
General Terms:

Trade Date:	[ ]
Option Style:	[American] [Bermuda] [European]
Option Type:	[Call] [Put]
Seller:	[Party A] [Party B]
Buyer:	[Party A] [Party B]
Index:	[ ]
Number of Options:	[ ]
[Multiplier:	[ ] <sup>10</sup>
Strike Price:	[ ] <sup>11</sup>
Premium:	[ ] [(Premium per Option [ ])] <sup>12</sup>
Premium Payment Date:	[ ]
Exchange:	[ ]
Related Exchange(s):	[ ] <sup>13</sup>
[Knock-in Event:	[Applicable] <sup>14</sup>

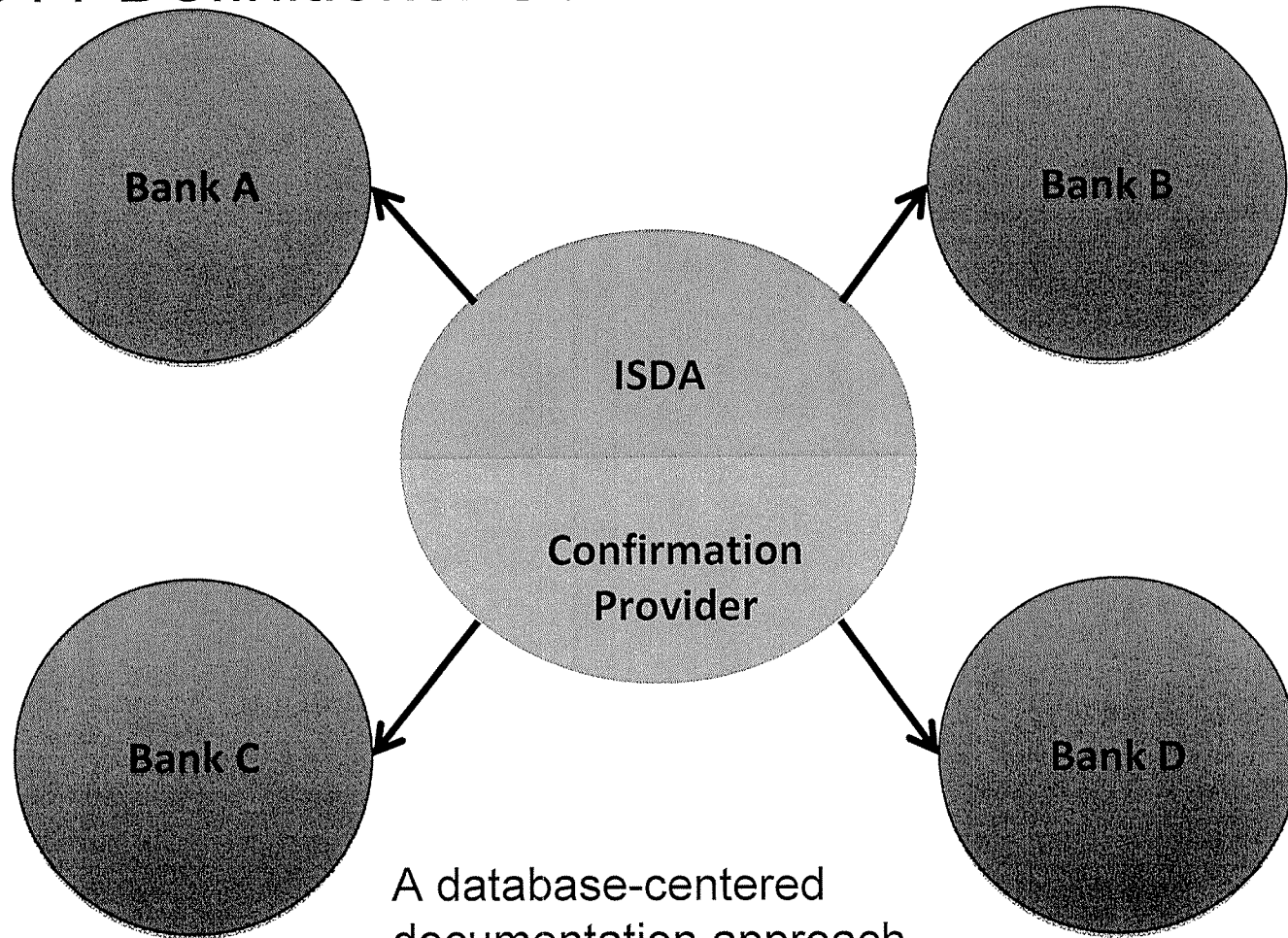
<sup>10</sup> Include Multiplier if it is intended that the Option Cash Settlement Amount will be based on a percentage of the performance of the Index or another amount.  
<sup>11</sup> This should be expressed as a level for the Index.  
<sup>12</sup> If Premium per Option is specified, the Premium shall be the product of the Premium per Option and the Number of Options.  
<sup>13</sup> If the parties specify "All Exchanges" as the Related Exchange, Related Exchange shall mean each exchange or quotation system where trading has a material effect (as determined by the Calculation Agent) on the overall market for futures or options contracts relating to such Index.  
<sup>14</sup> If Knock-in Event is applicable, specify the event or occurrence that will trigger the Knock-in Event. The parties must also specify what exercise, payment or delivery rights or obligations are conditional upon the occurrence of a Knock-in Event.

4

## 2002 Definitions: Decentralized Documentation



## 2011 Definitions: Centralized Documentation



A database-centered documentation approach allows for standardized, transparent agreements.

# 2011 Definitions – Fields & Elections

- Like the 2002 Definitions, the 2011 Definitions depend upon a Field and Election structure.
- Each trade consists of a unique combination of Fields and Elections.
- Unlike the 2002 Definitions, the 2011 Definitions provide a standard set of rules in which Fields are combined to form a trade.
- The 2011 Definitions are designed to facilitate an unlimited number of new definitions – but all on a **standard framework**
- Certain Fields will apply with respect to every trade. Most Fields will be subject to the applicability of certain elections in respect of a trade.

Trade-specific fields are only applicable if relevant features apply

## ED Transaction Supplement Terms

ED Transaction Type	Single-Exchange Index Equity Performance Option ED Transaction - OM1 - All Parties
Trade Date	4/6/2011
<b>Structural Leg Terms</b>	
Matrix Feature	USIO 1
Leg Number	1
ED Leg Reference Underlier	SPX
<b>Settlement Terms</b>	
Buyer	Party B
Cap Price	not specified
Equity Amount Recipient	Party B
Equity Notional Amount	
Equity Premium Amount	3,100 USD
Equity Reference Date	Trade Date
Equity Valuation Date	
Floor Price	not specified
N	
Number of Index Units	
Number of Option Units	100
Number of Securities	
Variance Buyer	
VolCap	
Settlement Feature	Cash Settlement
Valuation Features (other than ADTV Limitation)	
Electable Settlement System	
Settlement Election Cut-off Date	
Settlement Election Party	
<b>Pricing Terms</b>	
Strike Price Agreed Price	1335
Settlement Price Pricing Election	Close-Index Sponsor
Initial Price Agreed Price	
Final Price Pricing Election	
Pt-1 (Observation Period Start Date)	
Pricing Election	
Pt-1 (Observation Period Start Date)	
Agreed Price	
Pt (Equity Valuation Date) Pricing Election	
Volatility Strike Agreed Price	

	Completed	Upcoming deliverables	Next phase 2014 and beyond
<b>2011 Equity Definitions Matrix Publications</b> All Participants Through ISDA	<b>Completed Items:</b> <ul style="list-style-type: none"> <li>➤ Index Variance Swap – EUR/US</li> <li>➤ Index Variance Swap – Pan Asia</li> <li>➤ Volatility Swap EUR/US</li> <li>➤ Volatility Swap Pan Asia</li> </ul>	<b>Upcoming Deliverables:</b> <ul style="list-style-type: none"> <li>➤ Accumulator/Decumulator – November 2013</li> <li>➤ Dealer – Client Europe and Asia Emerging Market Swap</li> </ul>	<b>Next Phase – 2014 and beyond:</b> <ul style="list-style-type: none"> <li>➤ Additional products to be prioritised based on volume and member input</li> </ul>
<b>2011 Equity Definitions Implementation</b>	<ul style="list-style-type: none"> <li>➤ On-going build of different forms to aid education and adoption</li> <li>➤ Development of 2011 Definitions E-Reader continues</li> <li>➤ ISDA 2011 Definitions Implementation group currently reviewing internal implementation requirements in advance of agreeing implementation roadmap</li> <li>➤ Discussion continues with market participants, including MarkitSERV, regarding prioritisation into MarkitWire release schedule.</li> </ul>		