



International Swaps and Derivatives Association, Inc.

### **Disclosure Annex for Credit Derivative Transactions**

This Annex supplements and should be read in conjunction with the General Disclosure Statement. NOTHING IN THIS ANNEX AMENDS OR SUPERSEDES THE EXPRESS TERMS OF ANY TRANSACTION BETWEEN YOU AND US OR ANY RELATED GOVERNING DOCUMENTATION. Accordingly, descriptions in this Annex of the operation of Credit Transactions (as defined below) and the consequences of various events are in all cases subject to the actual terms of a Credit Transaction executed between you and us and its governing documentation (whether or not such qualification is expressly stated).

As used in this Annex, the term “**Credit Transactions**” refers to Transactions in which the Underliers are prices, levels, rates or contingencies related to the credit risk – such as the failure by an entity to pay principal or interest when due under a bond or loan – of one or more specified corporate or sovereign entities (each, a “**Reference Entity**”).

The terms of your Credit Transaction may incorporate by reference standard definitions and various other market standard terms, such as settlement matrices, standard terms supplements and forms of confirmation, which may be published by the International Swaps and Derivatives Association, Inc. (“**ISDA**”) or other publishers such as index sponsors. Such terms may in turn be amended or customized pursuant to the terms of the Credit Transaction and its governing documentation. Terms incorporated by reference or otherwise relevant to a Credit Transaction may include:

- the definitions and provisions of the 2003 ISDA Credit Derivatives Definitions published by ISDA, or any updated form of Credit Derivatives Definitions published by ISDA, as amended by any supplements specified in the Credit Transaction including, without limitation, the 2009 ISDA Credit Derivatives Determinations Committees, Auction Settlement and Restructuring Supplement published on July 14, 2009 (the “**Credit Derivatives Definitions**”);
- the Credit Derivatives Determinations Committee Rules, as published by ISDA and as amended and/or supplemented from time to time in accordance with the terms thereof (the “**DC Rules**”);
- the form of auction settlement terms published by ISDA and, in respect of any Reference Entity and a related Credit Event (as defined below), the specific auction settlement terms (if any) published by ISDA in respect of such Credit Event around the time of such Credit Event; and
- subject to the terms thereof, any protocol to which you and we adhere.

You should obtain and thoroughly understand any such materials as their content will materially affect your rights and obligations under the Credit Transaction, its value and its appropriateness for your particular objectives. Descriptions of the Credit Derivatives Definitions and DC Rules contained herein are summaries only and are qualified in their entirety by reference to the full text of the Credit Derivatives Definitions.

One of the most common types of Credit Transaction is a credit default swap. Under a credit default swap, one party agrees, in exchange for an upfront payment and/or series of periodic payments, to compensate the other party if a specified credit-related event (a “**Credit Event**”) occurs with respect to a Reference Entity. For example, if a Credit Event occurs, the party that has agreed to take the risk of the occurrence (the “seller” of credit protection) may become obligated to do one or more of the following, depending on the terms of the Credit Transaction: (i) to pay a cash amount determined as described below with respect to auction settlement under “Settlement Methods”, (ii) to take delivery of a specified amount of one or more obligations of the Reference Entity that satisfy certain deliverability requirements and are chosen by the other party (the “buyer” of credit protection) and pay 100% (or another percentage specified in the terms of the Credit Transaction) of the outstanding principal balance or due and payable amount, as applicable, of such obligation(s) and/or (iii) to make an equivalent cash payment based on the market value (as determined under the Credit Transaction) of the selected obligation or obligations. A related type of Credit Transaction is a “fixed recovery” credit default swap, under which a fixed amount specified in the terms of the Credit Transaction may become payable by the protection seller to the protection buyer if a Credit Event occurs. In other types of Credit Transactions, payment obligations of the parties may be defined by reference to the spread between the yield on a Reference Entity’s debt obligations and a risk-free rate. In some types of Credit Transactions, such as a “recovery lock” (in which parties’ obligations are based on the difference between the settlement amount under a credit default swap and a contractually-specified fixed recovery rate), either party could be “in-the-money” following a Credit Event and required to make payments or deliveries of the types described above.

If the relevant credit-related events do not occur during the coverage period of a credit default swap or similar Credit Transaction, then, subject to the terms of the Credit Transaction, the protection buyer typically will not receive any further compensation from the protection seller and will not be entitled to a refund of amounts it has paid during the term of the Credit Transaction.

## **Valuation Factors**

Factors that may influence the value of a Credit Transaction include:

- the actual or perceived creditworthiness and credit ratings of each Reference Entity and any guarantors or other supporters of its relevant obligations;
- the degree of correlation between the creditworthiness of a Reference Entity and that of your counterparty under a Credit Transaction;
- expected rates of recovery on obligations of the Reference Entity;
- actions of a Reference Entity and its principal creditors;

- the nature of each Reference Entity’s outstanding indebtedness, including its maturity and subordination structure and any guarantees or other support that the Reference Entity has provided to other entities;
- the contractually specified credit-related events with respect to a Reference Entity that may trigger settlement of the Credit Transaction;
- optionality that a party has under the terms of the Credit Transaction, such as the ability to select the obligations of a Reference Entity that will be delivered or valued or to decide whether or not to trigger settlement;
- correlation among the credit spreads and/or default probabilities of the components of a basket or index, if applicable;
- market liquidity for a particular type of Credit Transaction;
- interest rates and the amount of any periodic fixed payments required to be made under the Credit Transaction;
- the time remaining to the maturity of the Credit Transaction; and
- economic, financial, political and regulatory or judicial events or conditions that affect any Reference Entity or its outstanding obligations, or the market for Credit Transactions or related financial markets, including credit spreads in the market, market liquidity of Credit Transactions relative to the liquidity of related cash instruments or related credit derivatives, and liquidity for secondary assignments of credit derivatives generally.

#### *Counterparty credit exposure*

Counterparty credit exposure under a Credit Transaction may change abruptly following announcements or events (including Credit Events) relating to a Reference Entity. You should take this fact into account in monitoring and managing counterparty credit risk. See Section III.E – “Credit risk of named counterparty (and any applicable guarantors or credit support providers), prime broker, clearing broker or clearinghouse” – of the General Disclosure Statement.

#### *Market liquidity*

Various factors may affect the market liquidity for a particular type of Credit Transaction. Certain tenors of a type of Credit Transaction may be more liquid than others, and consequently market liquidity could vary during the term of a Credit Transaction. Future regulation of Credit Transactions could limit market liquidity. The market liquidity of Credit Transactions based on indices may vary significantly between the current series of the index and prior series. The market liquidity of Credit Transactions based on bespoke portfolios of Reference Entities will generally be less than that of Credit Transactions based on standardized indices. The market liquidity of a single-Reference Entity Credit Transaction may be affected by the Reference Entity’s inclusion or exclusion from a standardized index, with exclusion from an index generally expected to result in diminished market liquidity. Market liquidity affects the value of

Credit Transactions through its effect on bid-ask spreads and the ability of market participants to hedge exposures, among other factors. The existence of market liquidity does not necessarily mean that transfers, early termination or other sources of Transaction liquidity will be available to you with respect to a Credit Transaction between you and us. See Section III.B – “Transactions Involve Liquidity Risk” – of the General Disclosure Statement.

### **Interpretation of Transaction Terms**

The Credit Derivatives Definitions and other terms applicable to Credit Transactions are subject to interpretation and further evolution. Past events have shown that the views of market participants may differ as to how the terms of Credit Transactions should be interpreted in the context of specific events, entities and obligations.

### **Role of the Credit Derivatives Determinations Committees**

You should understand the role of the Credit Derivatives Determinations Committees (“**Determinations Committees**”) and how their determinations may affect your rights and obligations under a Credit Transaction. If so provided under the terms of a Credit Transaction, a Determinations Committee will have the power to make binding decisions on critical issues such as whether a Credit Event or a Succession Event has occurred, which obligations of the Reference Entity are deliverable, the terms of an auction (as described below under “**Settlement Methods**”) and, subject to the DC Rules, whether or not an auction will be held, and matters of contractual interpretation relevant to the credit derivatives market generally. The procedures of the Determinations Committees are set forth in the DC Rules. The DC Rules may be amended by a Determinations Committee in accordance with the DC Rules. None of ISDA, the institutions serving on the Determinations Committees or any external reviewers owes any duty to you in such capacity, and you may be prevented from pursuing claims with respect to actions taken by such persons under the DC Rules. Institutions serving on a Determinations Committee may base their votes on information that is not available to you, and have no duty to research, investigate, supplement or verify the accuracy of information on which a determination is based. In addition, a Determinations Committee is not obligated to follow previous determinations or apply principles of interpretation such as those that might guide a court in interpreting contractual provisions. Therefore, a Determinations Committee could reach a different determination on a similar set of facts. If we or an affiliate serve on a Determinations Committee, we may have an inherent conflict of interest in the outcome of any determinations. In such capacity, we or our affiliate may vote and take other actions without regard to your interests under a Credit Transaction.

Further information about Determinations Committees may be found at <http://dc.isda.org> (or any successor website). If your Credit Transaction is governed by the determinations of a Determinations Committee, you should carefully monitor the matters under consideration by such committees and their determinations.

### **Specification of Credit Events**

Examples of Credit Events that might apply to individual Credit Transactions include bankruptcy, failure to pay, restructuring, obligation acceleration, obligation default, and repudiation/moratorium. You should review carefully the applicable Credit Events and their definitions under each prospective Credit Transaction and independently evaluate their appropriateness to your objective for entering into the Credit Transaction.

There are established trading conventions, which generally depend on the type of Reference Entity and its geographical location, regarding applicable Credit Events, their detailed definitions and other terms of a Credit Transaction. You should be aware that Credit Transactions with terms that differ from these trading conventions may have substantially less market liquidity and price transparency. We cannot provide any assurances regarding the likelihood that we or another dealer would be willing to enter into a Credit Transaction with you on terms that differ from these trading conventions.

Whereas bankruptcy is a Credit Event that relates to the Reference Entity itself, other Credit Events, such as failure to pay or restructuring, relate to obligations of the Reference Entity that fall within a specified category (e.g., bonds, loans, borrowed money) and have specified characteristics (e.g., subordination, non-contingency of principal payments, currency, governing law). Depending on the terms of a Credit Transaction, obligations for which the Reference Entity acts in a capacity other than direct obligor (for example as a guarantor or insurer) may not be within the class of obligations that is relevant for purposes of determining whether a Credit Event has occurred.

You should be aware that a Reference Entity may decide to default on or restructure only certain classes of its obligations and such a selective default or restructuring may not result in a Credit Event for the classes of obligations that are relevant for a particular Credit Transaction.

### **No assurance that you will achieve your hedging or other objectives**

Credit Events are expressly defined under the terms of a Credit Transaction and may not encompass all of the circumstances in which you may suffer credit-related losses on an obligation of a Reference Entity. If you intend to hedge your exposure to the credit risk of owning an obligation of a Reference Entity, you must evaluate carefully whether the Credit Transaction will serve as an effective hedge. Some of the reasons why recovery under a Credit Transaction may not be available despite the deteriorating creditworthiness of a Reference Entity include:

- the obligor on the obligation you own is not correctly identified as the Reference Entity under the Credit Transaction, for example, due to confusion among similarly named entities within a corporate group or failure to take into account recent name changes or Succession Events (as defined below);
- the obligor on the obligation you own is acting in a different capacity – such as direct obligor, guarantor or insurer – than is specified in the Credit Transaction;
- the characteristics of the obligation you own – such as whether it is senior or subordinated, freely transferrable, secured or unsecured, a bond, loan or a payment obligation not related to borrowed money – do not meet or cease to meet requirements specified in the Credit Transaction relevant to either the occurrence of a Credit Event or the payments or deliveries to be made following a Credit Event;
- the scheduled termination date of the Credit Transaction precedes the maturity date of the obligation being hedged;
- the amount of a Reference Entity's payment failure or the aggregate amount of its obligations affected by the Credit Event is below the threshold designated in the Credit Transaction;

- adequate notice of a Credit Event or Succession Event or, if applicable, a request to convene the Determinations Committee is not made within the requisite time period following the Credit Event or Succession Event (as applicable); and
- the obligation you own is assumed by a different entity but the Succession Event provisions (as described below under “Succession Events” and “Operational Risks”) governing your Credit Transaction do not result in a corresponding change in the Reference Entity with respect to the appropriate notional amount.

### *Restructuring Credit Events*

Some entities that experience credit difficulties do not file for bankruptcy or default on payments on all of their obligations. Instead they may enter into work-out or restructuring arrangements with their creditors. Unless a Credit Transaction expressly provides for a “restructuring” Credit Event -- and the actual event falls within the agreed definition of that Credit Event, the protection buyer may not receive any compensation if such a workout or other restructuring occurs. You should ascertain whether a prospective Credit Transaction includes a restructuring Credit Event and ensure that you understand the applicable definition of “restructuring”, the requirements and conditions for you and your counterparty to trigger settlement following the occurrence of a restructuring, the maturity and other limitations that apply to deliverable obligations and the considerations that will inform each party’s decision as to whether to exercise such rights. For example, in some circumstances it may be beneficial for the protection seller to trigger settlement following a restructuring in order to preclude the possibility of having to make a greater payment should a subsequent Credit Event occur.

### *Requirement for Publicly Available Information*

Credit Transactions may specify that only publicly available information regarding a relevant event may be used to trigger or modify (such as with respect to a Succession Event) the transaction. The Credit Derivatives Definitions contain standards as to what constitutes publicly available information for Credit Transactions governed by those definitions. If a Credit Event or Succession Event occurs but the requisite public information about the event (as specified in the Credit Transaction) is not available within the applicable time periods, then the event will not take effect under the Credit Transaction.

### **Succession Events**

Succession Events may result in different or additional Reference Entities. Following certain corporate events relating to a Reference Entity, such as (in the case of a non-sovereign entity) a merger, consolidation, amalgamation, transfer of assets or liabilities, spin-off or other similar event in which an entity succeeds to the obligations of another entity, whether by operation of law or pursuant to any agreement, the Reference Entity may change. We refer to such events as “**Succession Events**”. Based on the proportion of the relevant obligations of a non-sovereign Reference Entity assumed by other entities in connection with a Succession Event, one or more entities (which may include the original Reference Entity) may be designated as successor Reference Entities. The Credit Derivatives Definitions provide that if a non-sovereign Reference Entity has more than one successor entity as the result of such an event, then the notional amount of the Credit Transaction will be split evenly among the successor entities. As a result, the Credit Transaction may reference substantially different credit risks following the occurrence of

Succession Events with respect to a Reference Entity. These credit risks could potentially be greater or lesser than the credit risk of the original Reference Entity, which could adversely impact the value of the transaction to the protection seller (if the credit risk increases) or the protection buyer (if the credit risk reduces). If you entered into a Credit Transaction to hedge an obligation you own, you should be aware that the Succession Event will not necessarily result in the assumption of that obligation by the successor Reference Entities either at all or in the same proportion as the allocation of the notional amount of the original Credit Transaction, in either case resulting in an ineffective hedge.

**The occurrence of certain events prior to the trade date of a Credit Transaction may affect its value.**

Under the Credit Derivatives Definitions, the relevant period for Credit Events that may trigger settlement of a Credit Transaction begins on the “Credit Event Backstop Date” (as defined in the Credit Derivatives Definitions), which may be prior to the trade date. In broad terms, the Credit Event Backstop Date refers to the start of a rolling look-back period of 60 calendar days prior to the date of a request (accompanied by the requisite publicly available information) to convene the relevant Determinations Committee or, if applicable, the effective date of certain notices required for settlement of the Credit Transaction. For Succession Events, a similar look-back period of 90 calendar days applies, and it is therefore possible that a Credit Transaction could be affected by a Succession Event that took place prior to the trade date.

You should conduct your own review of any recent developments with respect to a Reference Entity by consulting publicly available information. If, prior to the trade date, a request to convene a Determinations Committee has been delivered to determine whether a Credit Event has occurred with respect to a Reference Entity, details of such request may be found on the ISDA website at <http://dc.isda.org> (or any successor website). Even if a Determinations Committee has not been convened to determine such matter as of the trade date, one may still be convened after the trade date in respect of an event which occurs up to 60 days (in the case of a Credit Event) or 90 days (in the case of a Succession Event) before the date of a request to convene such Determinations Committee to make the relevant determinations.

**Operational Risks**

Credit Transactions can be more operationally intensive than other Transactions, and you must be prepared to deal with all of the operational aspects of Credit Transactions that you enter into. Credit Transactions may require that certain notices be given in order to exercise rights, realize value or protect and preserve interests under the transaction, including but not limited to notices of: the occurrence of a Credit Event or Succession Event together with supporting information; the choice of obligations to be delivered or valued; the exercise of buy-in rights in connection with physical settlement; certain potential Credit Events; and the exercise of the right to utilize parallel auctions (i.e., to move your Credit Transaction to a different “maturity bucket”) in the case of certain restructuring Credit Events. In some cases, determinations of a Determinations Committee may substitute for a required notice, modify the effect of a previously delivered notice or alter the period during which a notice may be delivered, but we can give no assurance that any such Determinations Committee action will occur. You should have arrangements for delivering and receiving such notices and monitoring the actions of the relevant Determinations Committees, and be prepared to take the necessary or appropriate steps when you receive such notices or learn of

such actions. Failure to act within the requisite time periods (e.g., the 60 or 90 day look-back periods described above with respect to Credit Events and Succession Events, respectively) could adversely affect your interests under a Credit Transaction.

## **Settlement Methods**

The ultimate outcome of a Credit Transaction (following the occurrence of a Credit Event and satisfaction of all conditions to settlement, if applicable) will be affected by the settlement method applicable to the transaction. The settlement methods below may apply directly to a Credit Transaction or, in the case of physical settlement or cash settlement, as fallback settlement methods in the event that auction settlement is the primary settlement method but an auction is not held.

### *Auction settlement*

If so provided, a Credit Transaction may be cash settled by reference to the price of certain deliverable obligations of the Reference Entity determined in an auction conducted pursuant to terms published by the Credit Derivatives Determinations Committee (“**auction settlement**”). Although, based on experience to date, auctions generally can be expected to be held for Credit Transactions of Reference Entities that are widely traded in the credit markets, there can be no assurance that an auction will be held for future Credit Events or that, if held, the auction will result in the determination of a final price. If an auction is not held or fails to result in the determination of a final price (as might occur if an auction is cancelled by the Determinations Committee due, for example, to an inability to obtain the requisite number of initial bids), the fallback settlement method specified under the Credit Transaction (generally either physical settlement or cash settlement pursuant to a valuation mechanism administered by one of the parties) would apply. If a Credit Transaction does not provide for auction settlement, it will generally specify either physical or cash settlement as the primary settlement method.

### *Physical settlement*

If physical settlement applies to a Credit Transaction, the protection buyer, in order to receive the physical settlement amount, must select (if the terms of the Credit Transaction provide the protection buyer a choice) an obligation or obligations of the Reference Entity that satisfy specified deliverability criteria and deliver those obligations to the protection seller in an amount determined in accordance with the terms of the Credit Transaction. You should be aware that physical settlement may not be possible to accomplish under some circumstances, including inability to procure the specified or selected deliverable obligation(s) due to market dislocations or prior redemptions or refinancings by the Reference Entity, failure to receive necessary transfer consents (such as from a borrower or agent) or delays in receiving such consents (beyond timeframes specified in the Credit Transaction), or court orders prohibiting transfers of an obligation. In such event, the terms of the Credit Transaction may provide the protection seller with buy-in rights, permit partial cash settlement subject to certain conditions or specify other fallback consequences, or the protection buyer may receive no recovery if it is unable to make a required delivery and fallback consequences permitting recovery do not apply. If you are the party to which obligations will be delivered under a Credit Transaction, you should understand any applicable restrictions on your ability to take delivery of a deliverable obligation, including under the terms of the obligation and applicable securities laws. The party making a delivery may



be deemed to make certain representations and give certain indemnities in connection with a delivery.

### *Cash settlement*

If cash settlement applies, the calculation agent or one of the parties may be required to seek quotations for selected obligations of the Reference Entity. You should be aware of the possibility that such obligations may no longer exist and no qualifying substitute obligations may have been identified, such quotations may not be available, or the level of such quotations may be substantially reduced as a result of illiquidity in the relevant markets or as a result of factors other than the credit risk of the Reference Entity (for example, liquidity constraints affecting market dealers). Moreover, the market value of a Reference Entity's obligations may be highly volatile in the period following a Credit Event. Accordingly, any quotations so obtained may differ significantly from the value of the relevant obligation which would be determined by reference to the present value of related cashflows, or the value that a party to a Credit Transaction could obtain if it controlled the disposition of the obligations. The price of an obligation may be deemed to be zero in the event that no such quotations are available.

### **Important Considerations regarding Auction Settlement**

If auction settlement is specified in a Credit Transaction, the relevant Determinations Committee publishes auction settlement terms in respect of the Reference Entity and an auction final price determination date occurs, settlement of the Credit Transaction will be based on the auction final price determined according to an auction procedure set out in the relevant Credit Derivatives Auction Settlement Terms, available on ISDA's website at [www.isda.org](http://www.isda.org) (or any successor website). Credit losses determined pursuant to a market auction process may be greater or less than the losses which would have been determined in the absence of the auction. In particular, the auction process may be affected by technical factors or operational errors which would not otherwise apply or may be the subject of actual or attempted manipulation. Auctions are conducted by the administrator(s) specified in the auction settlement terms.

The Determinations Committee may amend the form of auction settlement terms for a particular auction. The DC Rules provide for certain amendments by resolution of a convened Determinations Committee. Other amendments may be made subject to a public comment period; however, the DC Rules permit the Determinations Committee to forego a public comment period by supermajority action. Accordingly, there can be no assurance that the Credit Derivatives Auction Settlement Terms for a particular auction will be on similar terms to the form of auction settlement terms or the terms of previous auctions.

Where the only relevant Credit Event is a restructuring, several concurrent but separate auctions may occur with respect to the Reference Entity and such Credit Event. The auction settlement amount may be based on the price of one or more obligations of the Reference Entity having a final maturity date different from the restructured obligation.

If we or one of our affiliates acts as a participating bidder in an Auction, then we or it may take certain actions that influence the auction final price, including (i) submitting bids, offers and physical settlement requests (on our own behalf or on behalf of counterparties) with respect to the representative auction settled transaction and (ii) providing rates of conversion to determine the applicable currency conversion rates to be used to convert any obligations that are not

denominated in the auction currency into such currency for purposes of the auction. In deciding whether to take any such action (or whether to act as a participating bidder in any auction), we or our affiliate may, subject to the terms of the Credit Transaction, do so without regard to your interests. Such participation may have a material adverse effect on the value of a Credit Transaction.

### **Cheapest-to-deliver Option**

Subject to the terms of a Credit Transaction, the protection buyer may have discretion to choose the obligation(s) to be valued or delivered upon cash settlement or physical settlement of a Credit Transaction following a Credit Event in respect of the Reference Entity. In such cases, it is likely that the obligation or portfolio of obligations selected will be obligations of the Reference Entity with the lowest market value that are eligible for selection pursuant to the terms of the Credit Transaction. Obligations of differing maturities, currencies or payment priority (either contractual or under applicable insolvency law), among other characteristics, may diverge considerably in market value. This circumstance, which may occur for example when the Credit Event is a restructuring or the Reference Entity is a monoline insurer, would likely result in greater losses for the protection seller.

Similar considerations apply under auction settlement because the representative transaction that is priced in an auction generally allows a choice of deliverable obligations from a final list established by the Determinations Committee. In addition, wide divergences in expected recovery values among deliverable obligations could make it more difficult to conduct an auction. The class of deliverable obligations is determined under the terms of a Credit Transaction through the specification of categories and characteristics similar to those described above under “Specification of Credit Events.” A Credit Transaction may designate an obligation of the Reference Entity as a “reference obligation” for purposes of determining whether other obligations of that entity meet a criterion that deliverable obligations not be subordinated to the reference obligation.

### **Actions of Reference Entities**

Actions of Reference Entities (for example, merger or demerger or the repayment or transfer of indebtedness) may adversely affect the value of Credit Transactions. The views of market participants and/or legal counsel may differ as to how the terms of Credit Transactions should be interpreted in the context of such actions, or such terms may operate in a manner contrary to the expectations of market participants and/or adversely to the interests of parties to Credit Transactions. No Reference Entity will have any obligation to consider your interest (as a party to a Credit Transaction) as to any corporate or sovereign actions that might affect the value of the Credit Transaction. A Reference Entity may have an incentive to structure a transaction to produce a particular result under Credit Transactions, for example, in order to induce holders of its debt obligations to take certain actions.

In some cases, a Reference Entity may repay its outstanding liabilities or assign them to a different entity in a manner that does not give rise to a Succession Event or a successor Reference Entity. In such cases, a Credit Transaction with respect to that Reference Entity may no longer have deliverable obligations (a circumstance commonly referred to as an “orphan” Credit Transaction), which may result in significant losses for the protection buyer because it will be

precluded from recovery under the Credit Transaction but may remain obligated to make fixed payments. In certain circumstances, e.g., redemption of a “reference obligation”, the Credit Transaction may provide for designation of a substitute reference obligation by the calculation agent or the relevant Determinations Committee.

Some actions by a Reference Entity and holders of its obligations may have the effect of writing down the principal amount of its obligations, such as the addition of below-par redemption rights or an exchange of old bonds for new bonds in a lesser principal amount. Such modified or new obligations may trade at a higher percentage of their written-down principal amount than did the Reference Entity’s obligations prior to the write down. If the terms of an auction or other cash-settlement mechanism for a Credit Transaction determine the market value of the Reference Entity’s obligations by reference to the written-down principal amount, then the protection buyer’s recovery could be diminished or eliminated.

If the Reference Entity becomes an affiliate of the protection seller under a Credit Transaction, or one such entity merges with or makes a substantial asset transfer to the other, the value of the Credit Transaction to the protection buyer may be adversely affected because the credit risk of the protection seller after such event could become correlated or identical to that of the Reference Entity. Section 2.31 of the Credit Derivatives Definitions provides that a Credit Transaction may be terminated in such event, with the termination amount to be calculated and paid in accordance with applicable provisions set forth in the 2002 ISDA Master Agreement. You should be aware, however, that Section 2.31 (or a comparable provision) does not apply under the standard forms of confirmation for certain types of Credit Transactions, including certain index CDS.

**A protection seller will not have the rights of a holder of a debt obligation (e.g., voting, participation in restructuring)**

Unless otherwise agreed between the parties, the protection seller will not have rights equivalent to those of a holder of debt obligations of a Reference Entity, such as voting rights, rights to receive consent fees or other distributions from a Reference Entity. For example, if a restructuring occurs with respect to a Reference Entity, the protection seller, unlike a holder of a Reference Entity’s obligations, will have no right to challenge or participate in any element of the restructuring. If the protection buyer is the owner of one or more obligations of a Reference Entity, then, unless otherwise agreed, it may exercise its voting or control rights or otherwise act in its capacity as holder of such obligations without regard to the interests of the protection seller, and such actions could adversely affect the Transaction Economics from the perspective of the protection seller. Consequently, entering into a Credit Transaction as protection seller may be riskier than a direct investment in the obligations of a Reference Entity. Entry into a Credit Transaction differs from an offering of new obligations by a Reference Entity in that none of the money paid with respect to the Credit Transaction will go to a Reference Entity.

**There may be additional conflicts of interest that arise from Credit Transactions**

We or our affiliates may, now or in the future, engage in business with a Reference Entity, its affiliates and its competitors, including making loans to or equity investments in a Reference Entity, its affiliates and its competitors or providing it with investment banking, asset management or other advisory services, including merger and acquisition or bankruptcy-related advisory services. We or our affiliates may also participate in loan restructurings or recapitalizations that

may affect Credit Transactions, Reference Entities and any reference obligations. We or our affiliates may have an interest in data sources that publish credit indices and may participate in dealer votes to determine changes in the composition of indices. These activities may present a conflict between our or our affiliates' obligations and your interests as a party to a Credit Transaction. Please see Section IV.A. —“Our financial market activities may adversely impact Transactions” — of the General Disclosure Statement.

### **We may have information about Reference Entities that we cannot share with you**

We and our affiliates may, whether by virtue of the types of relationships described above or otherwise, at any time, be in possession of information in relation to a Reference Entity or any of its affiliates that is or may be material in the context of a Credit Transaction and that may or may not be publicly available or known to a party to a credit derivative transaction. Unless we expressly agree otherwise, the terms of a Credit Transaction do not create any obligation on our part to disclose to you any such relationship or information (whether or not confidential).

### **Public information with respect to issuers of Underliers may be inaccurate or incomplete**

Neither this risk disclosure statement nor any additional term sheet or disclosure statement is intended to provide information with respect to any Reference Entity, or any financial or other risks relating to the business or operations of any Reference Entity in general, or to the obligations of any Reference Entity in particular. You, as a party to a Credit Transaction, should make your own investigation into any Reference Entity. We make no endorsement, representation or warranty regarding the accuracy or completeness of the information publicly disclosed by a Reference Entity, whether contained in filings with the applicable securities regulator(s) or otherwise. Furthermore, we cannot give any assurance that all events occurring prior to the trade date of a Credit Transaction, including events that would affect the accuracy or completeness of the public filings of Reference Entity or the value of the Underliers will have been publicly disclosed. Subsequent disclosure of any such events or the disclosure of or failure to disclose material future events concerning an issuer could adversely affect the value of the Credit Transaction, its usefulness for your intended purpose, the timing or amount of payments or deliveries or the likelihood that you will be able to exercise any elective rights. You should undertake an independent investigation of each Reference Entity and Underlier as in your and your advisors' judgment is appropriate to make an informed decision with respect to entering into a Credit Transaction..

### **Additional Considerations for Specific Product Types**

The following is a discussion of certain material risks, terms and characteristics of some common types of Credit Transactions. The categories employed below are illustrative only, and are intended to assist you in understanding key features of certain prospective Credit Transactions. The discussion should not be viewed as a comprehensive description of any particular Credit Transaction that may be under discussion between you and us. Because nomenclature is neither standardized nor sufficiently descriptive to capture all important transaction features and variations, a particular Credit Transaction may have additional or different risks, terms and characteristics than described below, even if it is referred to by one of the following category names.

## **Sovereign Reference Entities**

There is no common set of rules or practices that governs the manner in which a sovereign government, faced with deterioration in its fiscal position or the performance of its economy, may attempt to reach resolution with holders of its debt obligations. Due to, among other factors, the role of governments and international organizations as creditors, the ability of a sovereign to enact legislation that may affect holders of its debt obligations, and the role played by other governments, including those of the jurisdictions in which private creditors are located, the development of events is inherently unpredictable. As a result, the caveat noted above that specified Credit Events may not encompass all the circumstances in which holders of a Reference Entity's obligations may suffer credit-related losses applies with even greater force in the case of sovereign Reference Entities.

Certain provisions of the Credit Derivatives Definitions operate differently in the case of sovereign Reference Entities. In particular, the obligations that are deliverable following a restructuring Credit Event may be determined based on characteristics of the obligation on the date immediately preceding the effective date of the restructuring. Additionally, events such as an annexation, unification, secession, partition, dissolution, consolidation, reconstitution or other events that result in any direct or indirect successor(s) may constitute Succession Events, and the Reference Entity of a Credit Transaction may change, irrespective of whether any successor assumes the obligations of the predecessor sovereign Reference Entity.

Under the trading conventions applicable to many Credit Transactions on sovereign Reference Entities, long-tenor obligations may be deliverable following a restructuring Credit Event. As a result, it is possible that there will be a wide dispersion in values among deliverable obligations, and interest rates and the maturity structure of the sovereign Reference Entity's deliverable obligations will be an important factor in determining the auction or cash settlement amount under such Credit Transactions.

## **U.S. State and Municipal Reference Entities**

Municipal debt securities are issued by U.S. states, counties, cities, special tax districts, and special agencies and authorities (such as a transport or electric power authority) of state and local governments. Municipal debt securities are classified according to whether they are backed by the full faith and credit of the Reference Entity or are payable from ad valorem taxes required to be levied on all taxable property within the taxing jurisdiction of the Reference Entity ("full faith and credit obligation liabilities"), payable from the general fund of the Reference Entity ("general fund obligation liabilities"), payable from a specified source of revenue (e.g., transportation fees) ("revenue obligation liabilities") or their payment is contingent on appropriations being made ("moral obligation liabilities"). This classification is relevant under Credit Transactions for determining whether an obligation-specific Credit Event has been triggered and which obligations are deliverable.

Obligations of the same Reference Entity can have materially different credit characteristics depending on their classification. Accordingly, it is important that you review and understand the consequences of the specified obligation characteristics under each prospective Credit Transaction, as they may materially affect your rights and obligations under the Credit Transaction, its value and its appropriateness for your particular objectives. In general, a different

set of characteristics may apply for purposes of defining Credit Events than for defining which obligations may be delivered or valued in connection with settlement. See “Specification of Credit Events” and “Cheapest-to-deliver Option” above.

Under the trading conventions applicable to Credit Transactions on U.S. municipal Reference Entities, bankruptcy is typically not specified as a Credit Event. You should be aware that municipalities may be eligible to be debtors under Chapter 9 of the U.S. Bankruptcy Code, subject to authorization under State law and certain other conditions. In the absence of a bankruptcy Credit Event, the filing of a petition or commencement of a case under Chapter 9 with respect to a municipality may not trigger settlement of a Credit Transaction, unless the surrounding circumstances also constitute one of the Credit Events that have been specified as applicable. Under applicable trading conventions, long-tenor obligations may be deliverable following a restructuring Credit Event with respect to a State or municipal Reference Entity. As a result, it is possible that there will be a wide dispersion in values among deliverable obligations, and interest rates and the maturity structure of the Reference Entity’s deliverable obligations will be an important factor in determining the auction or cash settlement amount under such Credit Transactions.

### **Tranche CDS**

A tranche CDS is a type of Credit Transaction on a portfolio of Reference Entities, under which the losses arising from Credit Events are transferred to the protection seller only to the extent that aggregate losses exceed the “attachment point” but remain less than the “detachment point” of the tranche. The likelihood that the protection seller will incur losses on a tranche CDS is greater for more subordinated tranches (i.e., those with a lower attachment point in relation to portfolio size). Tranche CDSs are leveraged instruments because the notional amount of a particular tranche is less than (and may be significantly less than) the notional amount of the entire portfolio of Reference Entities.

The value of a tranche CDS may be influenced by the correlation of changes in the creditworthiness of the Reference Entities in the portfolio, as well as by the valuation factors described above in relation to Credit Transactions generally. The weight of the probability distribution of portfolio losses that overlaps with a tranche is affected by correlation, expected spreads and other model-dependent factors. As a result, the allocation of the credit spread of the portfolio among tranches may change significantly, and in some cases abruptly, with market conditions. For example, an increase in idiosyncratic credit risks affecting only a few Reference Entities may tend to affect lower tranches disproportionately. Moreover, the valuation of CDS tranches is subject to “model risk” (i.e., the risk that a valuation model does not accurately depict the value of a tranche or the relationship between tranche values). Consequently, hedging or arbitrage strategies based on modeled relations between the values of tranches may break down, resulting in significant losses.

Where auction settlement does not apply, settlement of tranche CDSs is typically through a combination of cash and physical settlement. This combined settlement procedure may occur irrespective of whether aggregate losses have reached the tranche attachment point. Under this combined settlement mechanism, physical settlement typically is at a market value determined by a dealer poll following delivery of the selected deliverable obligations. Due to the later determination of the market value payment, settlement risk will be present for the protection

buyer, although it may be mitigated if the Credit Transaction provides for delivery-versus-payment (“DVP”) settlement based on an estimate of the market price.

### **Delivery of Loans; Loan CDS**

To the extent you may attempt to deliver or be required to receive loans as deliverable obligations under a Credit Transaction, you should be familiar with the documentation and settlement practices of the relevant secondary loan trading markets and applicable laws and regulations (including the legal consequences of furnishing or receiving non-public information regarding a Reference Entity). Considerations relevant to physical settlement include the representations and indemnities given under governing transfer documentation, the allocation between the parties of the risk of upstream title defects and, if settlement may occur through a participation or sub-participation, credit and other risks with respect to the participation grantor and any upstream grantors.

Provisions of the Reference Entity’s credit agreements may affect your ability to deliver or receive loans, the economic consequences of doing so and whether loans that you hold meet deliverability criteria. Accordingly, you should review such agreements carefully, including the provisions governing assignments, any collateral allocation mechanisms (i.e., a mandatory exchange of obligations for other obligations under a credit agreement, not all of which may be deliverable, depending on the terms of a Credit Transaction), and provisions that may require or entitle a lender to advance funds.

Some Credit Transactions, sometimes referred to as Loan CDS, do not allow the delivery of any obligations other than loans following a Credit Event, and even then may specify that only particular types of loans (for example, syndicated secured loans of a designated priority) are deliverable. Repayment or refinancing of a loan or release of the lenders’ security interest in collateral (such as may occur following an improvement in the obligor’s credit ratings) may result in a lack of deliverable obligations. See “Actions of Reference Entities” above. In the case of a loan refinancing, the obligor under a new credit agreement may not assume loans before their repayment (or the available public information may be insufficient to establish that such assumption has occurred). If the succession provisions in a Credit Transaction require such assumption, they may not result in the designation of a successor Reference Entity in such cases. Certain forms of published documentation contain modified succession provisions that may encompass a broader range of refinancing events. Before entering into a Credit Transaction on loans, you should review the succession provisions carefully and understand how they may operate in a range of refinancing scenarios. If a Credit Transaction is governed by the “Continuity Procedures for Bullet LCDS”, published by ISDA, binding determinations regarding succession may be made by a designated law firm in accordance with procedures set forth in that document.

Certain standard forms of Credit Transactions on loans provide for early cancellation should there cease to be deliverable loan obligations. You should be aware that this feature may make such Credit Transactions difficult to value. This valuation uncertainty, coupled with the migration of market participants to new standard terms that do not contain such cancellation provisions, may result in diminished secondary market liquidity for Credit Transactions with such cancellation provisions. See the discussion of market liquidity under “Valuation Factors” above.

A Credit Transaction may provide that the identification of loans that satisfy the ‘syndicated secured’ deliverability characteristic and have the relevant lien priority is made through a dealer poll and that certain other decisions, such as whether to hold an auction and which obligations are deliverable, will be made by dealers rather than a Determinations Committee. The documentation governing such Credit Transactions generally contains waivers of claims against the third parties making or administering determinations and provides that they have no duty to investigate or verify the accuracy of information on which a determination is based. If we or an affiliate participate as a dealer in making any determinations, we may have an inherent conflict of interest in the outcome of such determinations.

### **Pay-as-you-go CDS**

“Pay-as-you-go” credit default swaps (“PAUG CDS”) are a type of Credit Transaction developed for reference obligations that are asset-backed securities. PAUG CDS may reference a single asset-backed security or a portfolio of asset-backed securities, sometimes in the form of a published index. Asset-backed securities may have complex structural features whereby the timing and amount of payments due to holders of a specific class of asset-backed security are affected by the priority of payments among various classes of securities and the operation of coverage ratio, collateralization, and other structural tests. You should review carefully the governing documents of the reference obligation(s) of a PAUG CDS. The effectiveness of a PAUG CDS as a hedge of a particular asset-backed security will depend on the extent to which the terms of the PAUG CDS reflect the structural features of the asset-backed security and provide for possible contingencies that may affect the security.

PAUG CDS define a class of events related to the reference obligation and issuer as “floating amount events.” PAUG CDS may also define a second class of events as “credit events.” Certain types of events may be both “floating amount events” and “credit events,” and a PAUG CDS may allow for multiple settlement events to occur for a single reference obligation. The occurrence of a “credit event” may give rise to conditions to settlement and settlement obligations similar to those described above under “Settlement Methods - Physical settlement.” Credit events under a PAUG CDS may include events not defined under the Credit Derivatives Definitions, such as the principal and interest payment shortfalls and writedowns that could constitute a floating amount event (as described below), as well as a ratings downgrade of the reference obligation below a specified ratings threshold.

The occurrence of a floating amount event may require the protection seller to pay certain “floating amounts” to the protection buyer determined by reference to certain principal payment shortfalls, writedown amounts with respect to principal, and interest payment shortfalls. The terms of a PAUG CDS may include as an additional floating amount event an “implied writedown” with respect to principal, an event which the calculation agent may determine has occurred if there is a deficiency in the current value of the assets available to make payments both on the reference obligation and all liabilities senior and pari passu to it.

The terms of a PAUG CDS may specify that interest shortfall payments are subject to a cap, which may be fixed or variable. For example, a fixed cap may be set at a level equal to the periodic protection premium owed by protection buyer to protection seller. If the PAUG CDS does not contain a cap on interest shortfall payments, the protection seller is exposed to the full amount of expected interest payments on the reference obligation and thus a greater degree of



variability in the amount of the interest shortfall payments it may be required to make. Parties should note that interest shortfall amounts under a PAUG CDS may be determined by reference to an “expected interest amount”, a quantity that is to be calculated without taking into account certain caps and other provisions found in the governing documents for the reference obligation that would limit, defer, extinguish or reduce the interest payments due.

Upon the occurrence of an event that is both a “floating amount event” and a “credit event”, the terms of the PAUG CDS may allow the protection buyer to elect which of the two settlement mechanisms described above, or to specify that a combination of the two mechanisms, will apply.

The terms of the PAUG CDS may specify that the protection buyer is obligated to reimburse all or part of certain payments to the protection seller if the related writedown or shortfall amounts are ultimately paid to holders of the reference obligation or if the reference obligation is written up or, if applicable, the calculation of the implied writedown shows that the overall deficiency in assets has decreased. The protection seller under a PAUG CDS has credit exposure to the protection buyer in respect of such reimbursement amounts. The duration of this reimbursement obligation, as specified in the terms of the PAUG CDS, may differ from the period over which a holder of the reference obligation would be entitled to receive the corresponding reimbursement payments, and may continue for a period of one year or more beyond the termination of the protection provided to the protection buyer by the PAUG CDS.

Determination of the floating amounts and reimbursement amounts in relation to floating amount events, as well as satisfaction of the conditions to settlement in relation to certain credit events, may depend solely on the relevant servicer reports for the reference obligation being available and containing adequate information to enable the required calculations to be made. We can offer you no assurance that such reports will be available and contain adequate information. In particular, access to servicer reports may be limited if such reports are confidential and neither counterparty holds the related reference obligation. If a servicer report corrects information provided in a previous report and such corrections impact calculations made under a PAUG CDS, the terms of the PAUG CDS may provide for retroactive adjustments to be made (without accrued interest on the adjusted payments, unless otherwise specified in the terms of the PAUG CDS).

The amount of credit protection purchased or sold under a PAUG CDS on a specific asset-backed security may be greater or less than the actual outstanding principal balance of such asset-backed security, and in such instances the actual payment shortfalls, writedowns and reimbursements may be scaled up or down, as applicable, by a multiplier or “applicable percentage” in order to calculate the corresponding floating amounts and reimbursement amounts due under the PAUG CDS. In addition, the terms of the PAUG CDS may provide that floating amounts are only due and payable by the protection seller to the extent that the aggregate of all floating amounts calculated under the PAUG CDS exceeds a certain threshold, and that floating amounts cease to be due and payable by the protection seller when the aggregate of all floating amounts calculated exceeds a second, higher threshold.

Some PAUG CDS may include provisions granting voting or other control rights from the protection buyer to the protection seller; however, such agreement between the parties to the PAUG CDS is not binding on the issuer or trustee for the related asset-backed security and may be subject to conditions and requirements. See above under the heading “A protection seller will not have the rights of a holder of a debt obligation (e.g., voting, participation in restructuring)”.