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Restructurings vs. CDS A New Basis Reality

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CDS have long been analysed on the assumption that a basis package – long bond plus long protection – converges to par. In Europe, however, recent restructurings demonstrate that this anchor is weakening. The expansion of out-of-court tools such as UK restructuring plans, German StaRUG, Spanish pre-insolvency regimes, and French safeguard means that deliverables can be immobilised, extinguished, or converted into equity. Such outcomes can also be achieved without formal processes, if amendments are executed within existing bond covenants – as in Ardagh, where senior unsecured notes were equitised with more than 90% creditor consent.

It is worth underlining that CDS are not insurance products. They are financial instruments governed by the ISDA Credit Derivatives Definitions. The fine print matters. This places the Determinations Committee (DC) in a delicate position: it must adhere strictly to the legal framework, while at the same time ensuring that CDS continue to function as intended for market participants.

The DC has responded to recent European restructurings by invoking §3.2(d) to preserve auction mechanics, at times introducing “composite packages” that include instruments normally excluded from settlement.

This paper reviews three recent cases – Atos, Altice France, and Ardagh – alongside the Selecta 2020 precedent, and examines the implications for CDS settlement and the reliability of the basis trade.

A Tale of Two Markets: US vs. Europe in CDS Settlement

For years, CDS basis trades rested on a simple premise: a basis package should converge to par. A Credit Event occurs, deliverable bonds are auctioned, and settlement of CDS clears at 100 minus recovery. That neat mechanic is being challenged.

The assumption still holds in the **US**, where CDS trigger only on Bankruptcy or Failure to Pay. The Trust Indenture Act of 1939 prohibits changes to principal, coupon, or maturity without unanimous consent. Yet restructurings often occur out of court via exchange offers and LMEs, typically structured to maximise participation through exit consents or economics. Holdouts always remain, but those stubs continue to trade and are deliverable into CDS auctions. This ensures that even out-of-court restructurings produce standard CDS settlements.

In **Europe**, by contrast, majority-amendment frameworks – whether under national law (UK plan, German StaRUG, Spanish pre-insolvency) or insolvency law (French safeguard) – allow binding changes to debt terms. Because bonds can be extended, reduced, or converted into equity without unanimous consent, CDS in Europe retain a third trigger: Restructuring (MMR). But this broader scope has introduced settlement complexity. Recent cases show that basis packages may no longer settle uniformly at par.

Case Study I – Atos: Participation vs. Non-Participation

Atos entered accelerated safeguard in 2024. The DC classified this as a Bankruptcy Credit Event, consistent with safeguard’s character as a court-supervised process binding all creditors, with moratorium and cram-down features.

The CDS mechanism itself functioned as designed: settlement referenced the cheapest-to-deliver (CTD) bonds. Protection buyers who did not participate in the restructuring delivered old bonds into the auction and recovered close to 100 in their basis packages. Creditors who did participate, however, received a package of new notes, equity, and cash under safeguard “new money” privileges. Their basis packages recovered well above par.

Thus, CDS worked exactly as expected – payout was based on CTDs – but outcomes diverged. The difference was driven entirely by restructuring participation, not by the CDS framework itself.

How does a CDS Auction Work?

Since 2009, CDS settlements are standardized via the ISDA auction. The goal is to replicate physical settlement (protection buyer delivers a bond, receives par) in a uniform, cash-settled format.

Step 1: Credit Event & Deliverables

- > DC declares a Credit Event.
- > DC publishes a Final List of Deliverable Obligations (the bonds/loans that can be delivered).

Step 2: Initial Market Submissions (IMM)

- > Dealers submit bid/offer quotes for Deliverables.
- > These set an initial market level and establish inside/outside quotes.

Step 3: Physical Settlement Requests (PSR)

- > Buyers and sellers state how much notional they want to deliver/take.
- > This creates the open interest (supply vs. demand imbalance).

Step 4: Auction Matching

- > The open interest is cleared by matching PSRs against dealer orders.
- > The process produces a single Final Price (recovery value), expressed as % of par.

Step 5: Cash Settlement

- > CDS pays out (100 – Final Price).
- > Example: If the auction Final Price = 40, protection buyers receive 60 from sellers

Case Study II – Selecta / Altice France: §3.2(d) and Composite Packages

The Selecta Group B.V. restructuring in 2020 was the first corporate case in which the DC invoked §3.2(d). The relevant Credit Event was a Bankruptcy. After the restructuring, old bonds were exchanged into a mix of new first-lien notes, second-lien notes, and preference shares. Because the legacy obligations no longer circulated, physical settlement was impracticable. The DC amended the Auction Settlement Terms (AST) to define Composite Packages – fixed proportions of the new instruments – as deliverables. This was significant: it allowed preference shares, an equity-like instrument, to enter settlement via §3.2(d), without redefining Deliverable Obligations.

In Altice France (SFR) 2025, accelerated safeguard created a similar situation. More than 95% of bonds were locked under agreements that restricted transfer. Without free deliverables, the CDS auction was at risk of collapsing. The DC initially explored alternatives, including a cash-settlement construct and a “Failed Lock-up CDS” clause. Ultimately, it again used §3.2(d).

Under the Altice AST, CDS could be settled either with the very few non-locked-up bonds or as a fallback option with a composite package of new notes, cash, and equity, delivered on 1 October 2025. Equity’s inclusion was controversial, since it is normally excluded as a Deliverable. The DC emphasized that this was not a new method, but a procedural adjustment to keep auction settlement aligned with what physical settlement would have produced had the bonds survived.

In both Selecta and Altice, basis packages “worked” – but the innovation lay in the DC’s use of §3.2(d) to ensure continuity, first by incorporating preference shares, later by admitting equity. To date, such modifications have been used only in Bankruptcy or Failure-to-Pay (FtP) cases, never in a pure Restructuring (MMR).

Case Study III – Ardagh: When Restructuring ≠ Payout

Ardagh’s recapitalization is a case of an out-of-court restructuring executed entirely within bond covenants. With more than 90% consent, about \$2.4bn of Senior Unsecured Notes (SUNs) are being converted into 92.5% of the new equity, with the remaining 7.5% allocated to PIK noteholders. Once implemented, the SUNs and PIKs will be cancelled.

Given the level of consent and the contractual nature of the transaction, the DC is expected to classify this as a Restructuring Credit Event (MMR), rather than Bankruptcy. Under the ISDA Definitions, however, an MMR

only triggers once the restructuring has been implemented. At that point, the SUNs no longer exist.

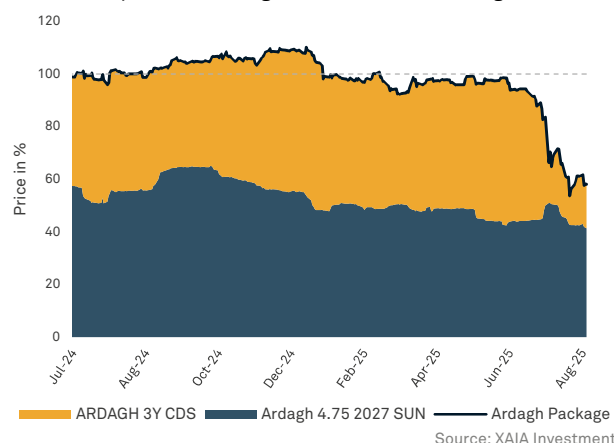
It is important to recall that CDS was designed on the assumption that, following a Credit Event, protection buyers could physically deliver a bond or loan into the contract. The auction is only a standardized way to replicate that physical settlement. In this sense, when the DC relies on §3.2(d), it is always asking: “If physical settlement had been the method, what would buyers have been able to deliver?” For §3.2(d) to apply, the obligation must still legally exist immediately after the Credit Event. In the case of SFR, the bonds survived the Bankruptcy credit event (CE) and were therefore deliverable.

By contrast, in Ardagh, the relevant Credit Event (MMR) coincides with the cancellation of the SUNs. At the moment the CE is triggered, there are no obligations left to deliver. That distinction matters: §3.2(d) cannot be used to conjure deliverables that have already been extinguished, because its mandate is only to tweak auction mechanics around instruments that still exist.

Unlike Atos, Selecta, or Altice — where auctions ran and basis packages converged around par — Ardagh may expose CDS protection to a zero outcome, not because the CDS framework failed, but because the restructuring eliminated the reference obligations at the very moment the CE occurred.

FIGURE 1: BASIS COLLAPSE

Price development of Ardagh SUNs and referencing CDS



Mechanisms Behind the Shift – Auction Rules, Asset Packages, Lock-ups

Recent DC practice highlights several structural pressure points:

- > **Trigger timing:** An MMR only triggers once the restructuring is implemented, which means the Credit Event type is only knowable very close to implementation. This timing creates uncertainty: investors may structure hedges expecting Bankruptcy or

FtP, but if the DC ultimately rules Restructuring, deliverables may already have been cancelled at the moment of the CE.

- > **§3.2(d) modifications:** Applied in Selecta and Altice (both Bankruptcy CEs), introducing composite packages that included preference shares or equity. So far, §3.2(d) has never been applied in a pure MMR case.
- > **Asset Package Delivery (APD):** Explicitly available under the 2014 Definitions for sovereigns and structured products, but not for corporates. In practice, the DC has mimicked APD via §3.2(d) to allow delivery of composite packages. If APD were extended to corporates, it could theoretically cure the MMR problem by allowing delivery of the replacement package (equity, cash, new notes) even if the original bonds are extinguished at the moment of the CE.
- > **Lock-ups:** Agreements can immobilize bonds ahead of an auction, creating the risk that no free deliverables exist and the auction could fail (e.g. Europcar).
- > **Equity delivery risk:** If old bonds convert fully into equity, CDS recovery becomes equity-market driven, highly volatile and potentially subjective if no listing exists.

Implications

These developments expose the fragility of the old assumption that basis = par.

- > **Structural Participation gap:** Restructuring participants might recover well above 100, while non-participants settle around 100.
- > **Trigger gap:** Hard Credit Events (Bankruptcy, FtP) still settle cleanly; MMR may leave no deliverables.
- > **Settlement gap:** §3.2(d) has allowed composite packages with prefs/equity, but this remains untested in MMR.
- > **Jurisdiction gap:** US CDS cover only Bankruptcy and FtP; Europe adds MMR, with the attendant complexity of different legal regimes.
- > **Timing gap:** An MMR only triggers on implementation, so the CE type is only knowable very late; by then, bonds may already have been cancelled. If Asset Package Delivery (APD) were extended to corporates, it could cure this problem by allowing delivery of the replacement package even if the bonds vanish at the CE date.

Conclusion: Basis risk is in European restructuring situation no longer a mechanical arbitrage. It is a legal and structural trade. Managing it requires analyzing lock-ups, settlement mechanics, and DC precedent – not just spreads and deliverables.

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